STORAGE-ITEM
LPC-MAIN

LP9-R10E
U.B.C. LIBRARY

Tuum est

Library
of the University of
British Columbia

Accession No. 129077
Call No. HF 5566. T7

C.E.S. Dec 41.

CREDIT AND ITS MANAGEMENT

CREDIT *and* ITS MANAGEMENT

BY

J. H. TREGOE

Formerly President and Executive Manager
National Association of Credit Men
Professor of Finance
University of Southern California

HARPER & BROTHERS PUBLISHERS
NEW YORK AND LONDON
1930

CREDIT AND
ITS MANAGEMENT

Copyright, 1930, by
Harper & Brothers
Printed in the U. S. A.

First Edition
K-E

CONTENTS

PREFACE vii

I. THE HISTORIC BACKGROUND OF CREDIT 1
II. THE CHEMISTRY OF CREDIT 14
III. THE VARIOUS TYPES OF CREDIT 26
IV. THE USES AND ABUSES OF CREDIT 36
V. THE CREDIT DEPARTMENT AND ITS MANAGEMENT 43
VI. THE PROPER APPRAISAL OF THE CREDIT DEPARTMENT 49
VII. QUALIFYING FOR CREDIT MANAGEMENT 56
VIII. THE CREDIT SENSE 63
IX. CREDIT ECONOMICS 70
X. THE CREDIT MANAGER'S TOOLS—THE FINANCIAL STATEMENT 78
XI. THE CREDIT MANAGER'S TOOLS—CREDIT EXPERIENCE INTERCHANGE 87
XII. THE CREDIT MANAGER'S TOOLS—MERCANTILE AGENCY REPORTS 98
XIII. THE CREDIT MANAGER'S TOOLS—VARIOUS SOURCES OF INFORMATION 105
XIV. CREDIT CORRESPONDENCE 112
XV. CLOSING THE ACCOUNT 120
XVI. THE CREDIT MANAGER AND BUSINESS LAW 129
XVII. COMMERCIAL FAILURES—THEIR CAUSES AND PREVENTION 138
XVIII. CREDITS AND THE BANKRUPTCY LAW 146
XIX. CREDIT CRIMES 157
XX. FRIENDLY LIQUIDATIONS 167
XXI. BUSINESS SERVICE 177
XXII. CONCLUSION 186
BIBLIOGRAPHY 191
INDEX 193

Digitized by the Internet Archive
in 2010 with funding from
University of British Columbia Library

http://www.archive.org/details/credititsmanagem00treg

PREFACE

The author does not offer this book as an elementary treatise on Credit. His purpose and desire are to share with his readers the experiences and convictions gathered in nearly four decades of credit activities. During these years of constant application and study he derived the greatest satisfaction from an analysis of the human element, the discovery of its chemistry, and the manner in which its uses and misuses have reacted on our financial welfare.

Credit management is a new profession, though credit itself is old. The relations of a good credit technic to the prosperity of our people, to higher standards of living, to our rapid accumulation of capital, were not demonstrated until the twentieth century. It was during the closing years of the 'nineties that the National Association of Credit Men was organized. The first thing it accomplished for our credit welfare was fixing a principle upon which all credit expansion and the safety of its uses were founded. This principle was Cooperation.

We had not learned in our earlier years the real and secret reasons for the various crises that retarded our progress at times. It has been our good fortune in recent years to gather a knowledge of credit elements and to understand why these disturbances occurred. And from this knowledge it was possible to chart the channels of credit so that thereafter its worst dangers could be avoided.

To the close observer it is obvious that when credit is properly used there follows prosperity, progress, and contentment. It is equally obvious that when the rules of credit are violated, fatalities and distress will inevitably occur. Our rapidly growing industries and commerce have not allowed the knowledge of credit and its management to expand with its widespread uses, and there may be discovered now a distinct tendency to direct credits by mechanical processes. Mass-production methods have made themselves felt, and the author has no profounder purpose than to make clear the professional and human aspect of credit management and to show that it does not lend itself to mechanical control and processes.

J. H. Tregoe.

July 10, 1930.

CREDIT AND ITS MANAGEMENT

CREDIT *and* ITS MANAGEMENT

CHAPTER I

THE HISTORIC BACKGROUND OF CREDIT

Rapid movements, complex activities, and strenuous competition mark the present period of our financial and mercantile commerce. In such an atmosphere attention needs to be given to the background and to the elements of our most active economic practices. Specifically, writers on credit have confined themselves more to the uses of credit in modern business than to its evolution through the various stages of human development.

Credit did not grow up overnight. Human contacts and experiences are its generators. When resolved into its primary elements, credit is an exceedingly simple human function and it is not conceivable that in any period of society credit in some form or fashion was not practiced.

Getting goods from one who has them for sale or exchange, by one who takes them upon agreement that payment will be made at a future time, is a phenomenon which must have happened when society was not so sophisticated and the needs of people were of a most simple nature. The earliest known merchants, the Phœnicians, when starting out on their trading voyages around the Mediterranean basin, carried goods of home production or which were brought from countries beyond the desert. The voyagers in many instances were supplied with these goods, upon their promise that equal value would be given for them when their trading trips were over and they had brought back the consideration for which the goods had been exchanged.

These trading operations were generally of a barter nature, but the deferment of payment in goods of equal value constituted credit transactions. The real nature of what had taken place in these early exchanges and the medium that had been used to effect them were not understood in all of their significance. Yet only in degree did those transactions differ from credit exchanges today.

The Renaissance brought to Europe not alone a revival of learning and a new national spirit, but it gave a dynamic force to trading. The Mediterranean, which had witnessed the activities of Phœnicia, Carthage, Greece, and Rome, realized a new birth of commercial intercourse between peoples of distant countries. They were brought together, through their ingenuity and trading impulses, to satisfy the rapidly developing needs of a newly created Europe. Shakespeare's "Merchant of Venice" was woven around a credit transaction.

The enterprising merchants and traders of the aggressive Italian cities bought goods in the Far East, distributed them over Europe, and though the accounting records of these transactions do not exist in sufficient form to indicate just exactly how the exchanges were perfected, yet unquestionably in the marketing of these goods credit, to some extent at least, must have obtained.

The ingenious Anglo-Saxon, glimpsing what could be accomplished by faster production and better marketing, brought on through his perseverance what we designate historically as the "Industrial Revolution." This enterprising pioneer in industry turned one eye toward power production and the other eye toward a medium of exchange more adaptable to expanding production and economical marketing than barter or money had proved to be.

Passing over some intervening years and taking a glimpse of the business manners and customs of our Colonial forebears, we discover that the Virginia planter was an almost constant debtor to his factor in England. Having established his credit line with this factor, the planter would satisfy his needs during the growing season. When his tobacco was harvested, he would ship it direct from the plantation to his factor and have the proceeds of its sale applied to the liquidation of his accrued indebtedness.

During our Colonial period the merchants of New England bought goods abroad on credit. This credit was of long duration, and without the technic that recent years have developed it reduced the volume of goods that the marketing houses abroad could safely sell. This simple form of credit, even though it fell within the border-line of a commercialized system, was the infant that would in decades grow to large stature. The elements of credit were not comprehended. Credit was then merely a simple method for satisfying the simple needs of people, and it was extremely easy to make mistakes in using it. The absence of credit knowledge in the early days of our history is strongly evidenced by the issues of paper currency; this was resorted to by most of the Colonies and used largely for financing the War of the Revolution. It had no provision usually for its ultimate liquidation, and thus failed to conform to one of the rudimentary principles of good credit.

The financial genius of Alexander Hamilton was most forcibly expressed in his attitude toward debt and his philosophy that where a debt is contracted there must be set up the means of extinguishing it. Hamilton appeared to understand the mystic elements of credit. The application of his genius to the working out of our serious financial problems gave character to the new nation and set its face in the direction of progress. Aside from his legal practice Alexander Hamilton became interested in banking. He assisted in organizing the Bank of New York, New York City, which had for its pattern the Bank of North America, Philadelphia—the first incorporated bank in our country and the only one in existence when the Bank of New York was organized.

Hamilton was much interested in the financial problems of the Continental Congresses and he corresponded with Robert Morris, the leading financier of the period, concerning the embarrassing situation into which the Colonies had been plunged. Though young at the time, Hamilton evidently grasped the real horns of the dilemma and with his usual initiative submitted his ideas to Mr. Morris. Washington expressed his confidence in this rising young genius by appointing him Secretary of the newly created Treasury Department. The government, just created by force of the Constitution, had inherited foreign and domestic debts of formidable size. To extinguish these and to provide revenue for running expenses, plans were necessary which defied the average financial capacity of those days and required a real genius to conceive and execute.

The acumen of Hamilton, when faced with this gigantic task, quickly recognized the value and necessity of a well-organized bank. His credit foresight discerned the orderly shaping and stability such an institution could give to public and private finances. As a reservoir of credit, the bank could assist the government in its financial operations by loans in emergency periods, could give uniformity to note currency, and help the expansion of home industries. In a classic report, the creation of a national bank was recommended by Hamilton to Congress, and the closest scrutiny fails to show that a single claim made by Hamilton was unfulfilled. Its administration was in the hands of an excellent banker, Thomas Willing, a former partner of Robert Morris, and through its career of twenty years it gave great assistance to the Treasury Department and brought about an orderliness in currency and credit matters that was nothing short of astonishing when one realizes the conditions which existed when our nation started on its real career.

Passing over the intervening decades we find another climax to credit inflation occurring in 1873. The orgy of speculation during this brief period exceeded in magnitude and folly that of any previous era in our history. Railway building had completely captivated the imagination of the people; rails were laid, companies organized, and securities offered the public much beyond their financial ability to absorb. There also existed at that time a deficiency of character in public and private circles. Credit was subjected to the grossest treatment, and when the climax came the intensity of it and the wreckage that accompanied it were appalling. The previous major panics were not to be compared in financial losses, commercial and bank failures, with the misfortunes of that year. The records disclose that in 1873 there were 2,490 national and state banks operating. Their combined capital amounted to $526,000,000, their circulation to $336,000,000, and their deposits to $722,000,000. At that time the payment of specie had not been resumed after its suspension in 1861; there were probably not more than $25,000,000 gold in circulation. The situation that these figures disclose makes evident once more that good banking judgment had been lacking and that credit was roundly abused.

The year 1876 marked the first centennial of the Declaration of Independence and was commemorated by a very imposing exposition in Philadelphia, which contributed a great service to our industrial development and which set in motion many thousands of our people who never before had traveled beyond their own firesides. It marked a transformation in our aspirations and economy such as no previous event had done. It proved to be a meeting-place of the peoples of the world, and there was mutual amazement over the progress made by the United States in agricultural development and over the interesing wares produced by other nations. Up to the time of the Exposition, with the exception of about three years, the goods we had bought abroad had exceeded in value the goods we had shipped abroad. But the stimulation of this event turned our foreign trade about; thereafter, with the exception of three years, the goods we shipped abroad exceeded in value the goods we bought abroad.

The adolescent period in our industrial and financial career dated from the resumption of specie payment on January 1, 1879. For nearly two decades our public and private finances labored under the burden of a depreciated currency, and this condition intensified the credit problems of that period. The late 'seventies marked the organization of iron and steel companies, the forebears of the most influential corporations operating in this field today. The energy and initiative of capital and industrial leadership exceeded greatly the country's credit ability. The manner in which credit was eventually brought under expert control and was made the foundation of our progress gives a romantic touch to our commerce of the last half-century.

At the threshold of the last two decades of the nineteenth century, electric lighting was in its infancy, electric transportation had not passed beyond the stage of experiment, and the telephone was just coming into use. Capitalizing these inventions called for resources beyond our capacity, and throughout the 'eighties there was a severe competitive struggle. Ethical control, that has become a byword in modern marketing, and cooperation, that has been found an indispensable ingredient of credit intercourse, were unrecognized. It was a contest wherein the hardiest survived, and in order to save serious losses and failures, destructive competition was sought to be controlled by trusts, gentlemen's agreements, and holding companies. These new forms of combination appeared menacing to the people, who looked upon them as invaders of their interests, and in response to a wide demand Congress, in 1890, enacted an anti-trust law which is still in effect.

In 1880 we enjoyed the novel experience of a favorable balance in our foreign trade. In its fiscal operations the government reported a surplus that year of $69,000,000. Trading was carefully carried on, and during the year only 5,000 concerns failed, with liabilities of $66,000,000. The industrial picture of 1880 was progressive but not brilliant. Steel was just beginning to be commercialized and the plants produced 1,247,335 tons. The products of our factories were valued at about six billion dollars. Petroleum was at the beginning of its remarkable career. The deposits in all our banks were estimated at a little more than two billion dollars. There were in operation at that time 2,052 national banks, the combined deposits of which were $766,000,000. Their circulation amounted to $322,000,000, their loans to $934,000,000, and they possessed but $79,000,000 in specie. Placing these figures side by side with the financial and production statistics of today, they appear very small and make all the more wonderful the progress achieved since.

The Silver Coinage Act of 1878 was proving embarrassing to the currency situation at the beginning of the 'eighties. The commercial ratio of gold and silver was out of alignment with the minting ratio of sixteen to one. The gold base in 1880 of the deposits and circulation liabilities was far too small for safety. As a result of credit overstrain a serious pinch occurred in 1884 with the effect of disturbing business and causing 11,000 failures, with liabilities of $226,000,000. A comparison of the failure liabilities of 1880 and 1884 clearly revealed that in this short period credit complications and inflation had taken place, and to restore the situation expensive adjustments were necessary. Upon analyzing this credit episode and its causes, we find that there was an excellent surplus that year in the government's fiscal operations, but the national banks in four years had increased 25 per cent; their deposits had increased 50 per cent; in note circulation there was a small decline, but their loans had increased nearly 50 per cent. The specie holdings of the national banks in four years had increased $35,000,000. The gold base of deposit and circulation liabilities was again found to be uncomfortably small; the loans and circulation of the national banks were about equal to their combined capital and deposits.

The credit disorder of 1884 found expression more in a convulsion in the stock market than in commerce. The early 'eighties were marked by serious defalcations and failures in high places. Character, one of the important elements of credit, was not sufficiently displayed to bolster up confidence and it was not difficult in such a situation to disorganize trade and to throw the people into a panic. The picture of the 'eighties is one of desperate striving for traffic and trade, but through it all there was a movement toward better things, which could not be realized until other growing pains had been overcome.

As the 'nineties opened, the stage was set for another tragic drama. The desire among a segment of our people for the injection of more silver into the currency created an intense financial problem and gave unsoundness to the credit situation. Another concession to the proponents of silver was made in 1890. Almost coincident with this concession Congress had made unwise appropriations, a new tariff measure was thrust upon the people, and speculation throughout the world was riding for a serious fall. The embarrassment of an important banking house in London gave the first warning of the disaster that would occur in 1893.

Reviewing our industrial situation in 1890, we find steel production the largest in its history, a production that had trebled in ten years. The production of pig iron registered the same increase, petroleum production very nearly doubled in the decade, and the output of copper increased from 27,000 tons in 1880 to 115,966 tons in 1890. The financial side of that year's statistics reveals an increase in our national banks of one-third since 1884. The deposits of the national banks had increased one-fourth in six years and their circulation had decreased three-fifths. The loans of the national banks had increased 40 per cent since 1884 and their specie holdings had increased 50 per cent. The reserve of specie to deposits and circulation liabilities was about 12 per cent. The credit situation as revealed in this condition gave glimpses of great danger and there was a warning in the figures which a better knowledge of credit elements would have been able to understand. The state banks increased from 754 in 1883 to 3,579 in 1893; thereafter they were destined to out-number the national banks. The loans of the state banks increased from $322,000,000 in 1883 to $758,000,000 in 1893.

The bubble of inflation broke with extreme severity in 1893, when President Cleveland was contending with unsound money theories and striving, with eventual success, to stop the purchase of silver under the Act of 1890. The severity of this panic is almost indescribable. Credit had been roundly abused and was demanding a settlement of its abusers. The mercantile and bank failures numbered 15,000 with liabilities of $347,000,000. The situation had been aggravated by an unfavorable balance of trade, there was a fear that we would go on a silver basis, and foreign investors sought to dispose of their holdings of American securities. We exported $88,000,000 in gold; many banking institutions, especially in the Far West, were unable to liquefy their loans and a number of them failed as a result. We have never since then passed through such an extreme episode of misused credit and unsound banking practice. The extent of the damage in 1893 can be appreciated by the fact that proportionate losses today would amount to not less than a billion and a half dollars.

When the atmosphere had cleared sufficiently after the disaster, the credit managers recognized clearly that something was radically wrong with our credit mechanism, and that unless the defect was corrected there would be recurrences of the disaster from time to time. Meanwhile politicians, economists, and bankers were engaged in a desperate debate over the free-silver theory. It was an outstanding era in our financial history, when the nation's progress could be seriously retarded. We were in a most serious situation and the pressure to drive us in the wrong direction was almost irresistible.

Into the credit field there now entered humanizing ideals. No business worker had been more competitive or heartless; no mercy was shown in credit competition; deceit and half-truths were thought shrewd; cooperation was unknown. Getting the credit managers together for correction of unfair practices was suggested by several office journals, and eventually a convention was held at Toledo, Ohio, in 1896. From this emerged the National Association of Credit Men, which has survived to the present time and been a most useful servant of the nation's business. Examining the need for other repair work, none towered so high as a correction of the disorders created by various state insolvency laws. The credit manager had to know his rights and risks in every state, and many of the laws were most unfair to distant creditors. Despite the antipathy to national bankruptcy laws, the building up of a safely functioning credit technic demanded a uniform insolvency law; a federal law only would answer and a national bankruptcy bill, which had been debated several years without definite progress, received the association's support and became a law in 1898. This law marked definite progress in sound credit development; criticisms have been aroused by its administration, but it would be no more possible to erect a building without a foundation than to build a safe credit structure without a national bankruptcy law.

The nineteenth century closed with credit managers highly ambitious for other progressive movements. Cooperation became a motivating principle of credit practice and the old ideas were gradually abandoned. Credit managers sought to control any unfairness in their relations to one another and in their attitude to debtors; they were looking at their problems eye to eye. Without these mental attitudes credit would have continued to be a dangerous currency. While the unsound silver theory persisted, the task of building a credit technic proceeded slowly. But when the dawn of reason led Congress in 1900 to enact the Gold Standard Act, the stage was set for one of the most stirring dramas of financial and industrial progress ever played by a nation.

In 1900 we passed for the first time the billion-dollar mark in our exports, and the proportion of manufactured goods sent abroad had increased from 15 per cent in 1820 to 36 per cent in 1900. The imports of 1900 were not quite a billion dollars, so there was a favorable balance of trade. The deposits in our banks had very nearly doubled in the decade and the check clearances had increased one-half. There was an excellent surplus in the Treasury. The loans and deposits reported by the banks were drawing closer together and indicated a much safer credit situation; installing credit departments was recognized as good banking practice.

The industrial field presented some very interesting statistics; steel production had more than doubled in the decade; petroleum production had nearly trebled; copper was more and more needed in the electrical field and its production kept pace with steel. The wastefulness of unrestrained competition was recognized to be unjustified, consolidations carried a strong appeal, and in 1901 our first billion-dollar enterprise, the United States Steel Corporation, was organized. The trend appealed to the speculative fancies of the people and again we were submerged in a frenzy of overnight riches that did not subside until many speculators had been thoroughly shattered. When this episode of speculation had run the usual course the prospects of substantial development by dint of hard work became attractive. In 1903 industry building, through skill and application, with the aid of expanding credit facilities, was firmly set, and our modern era of prosperity and progress began in earnest.

By the side of this thoroughly aroused industrial spirit, credit managers were seeking to improve the prevailing credit methods and to build a rational system. Though not at first appreciated, we realize now that industrial expansion depended upon safe credit expansion. In order to keep pace with the constant pressure of production, the managers of credit had to devise labor-saving methods; exchanging experiences on buyers, borrowers, and debtors which had been done directly by credit departments was transferred to bureaus set up by associations of credit men. This credit service now extends throughout the country.

Legislatures were appealed to and as a result statutes were enacted that have protected in a very great degree the sanctity of credit transactions. When ethics in trade were at a low ebb, selling stocks of goods in bulk was a favorite method of defrauding creditors; the possibility of this kind of fraud has been almost eliminated by statutes in all states and territories. Laws were also enacted reversing the common-law rules of evidence in many states, whereby the maker of a financial statement must prove its good faith and accuracy, instead of requiring the creditor to prove its falsity.

In the middle of the first decade of the twentieth century, when business and credit were making progress, there occurred a very serious credit strain in the New York stock market. Bank credit had been unwisely used for stock manipulation, and following several symptoms the delirium broke with intensity in 1907 and gave a short but severe shock to our banking situation. This battle of the financial giants caused no great interruption to our progress. A canvass of our status in 1910 revealed some extremely favorable records. In that year our exports approached the two-billion-dollar mark and the balance of trade in our favor was the largest we had ever enjoyed. Steel production showed a trebled output in the decade, and our factories turned out in finished values twice the production of ten years before. Petroleum had also made great strides in production, and all along the industrial front splendid progress was shown.

But if industry and marketing were to be saved from further shocks of badly controlled banking, a centralized controller was necessary. The National Bank Act had served a useful purpose, but its limitations were evident in the growing needs for credit and flexibility. A movement was inaugurated in 1908 to obtain a centralized system for banking and currency flexibility, and the debate and many episodes attending this form one of the most interesting chapters in our financial history. The movement resulted in the Federal Reserve System, authorized by act of Congress in December, 1913. No one recognized more clearly the need of a stabilizer in bank credits than did the credit men. They fought earnestly and persistently for a central banking system; they supported the Federal Reserve bill whole-heartedly, and when it was enacted as a law they were confident that serious panics need never again occur.

The control and services exacted and granted by the original act and its amendments have permitted the Federal Reserve System to add greatly to the value of our new credit technic. The importance of the new banking system was vividly displayed during the war period, which also revealed that our credit system was able to stand a severe strain. It was providential that wider credit facilities and greater skill to control them should have been available at the beginning of such a severe test; the demands upon our resources brought a response not alone in human courage, but in credit facilities without which the struggle might not have gone so well.

The magnitude of the credit transactions during and immediately after the war, resulting in a national debt of twenty-six billion dollars, clearly displayed a stability and flexibility in our credit genius that compensated many times for the untiring efforts of three decades of skillful and intelligent credit management. The inflation of prices and production as an aftermath of the war subjected the Federal Reserve System to a severe strain. The credit managers first discerned the dangers of this commodity orgy. Caution was urged, and though the body of business bent almost to the breaking-point under the burden of this thoughtless speculation, the break did not occur, and after a little pause for recuperation recovery began in 1923.

Six years of optimism and usually good management have been granted us. Slightly retarding but not serious shocks have occurred every now and then. Reaching 1929, we find our industrial production at its peak and records will be established in several major industries. The banking situation has kept pace with financial needs, our monetary stock of gold now comprising more than 40 per cent of the monetary gold in the world. The minting of credit in our banks for commercial needs and in our mercantile houses have shown good control, and there appears to be but one danger—a temptation to mass production of credits by mechanical processes. Following the alliance of industry and credit in the modern era as related in this narrative, we must realize clearly the individual skill and prudence required in creating credits; this skill cannot be delegated to any system of mechanics.

Safety in large credit transactions and the necessary fluidity of credit for banking and commerce can only be assured by strong, independent, courageous, and intelligent individuals trained for their work. The story of our industrial progress and of our wealth is the story of credit development. Human beings cannot survive without air; business cannot survive without the vitalizing element, credit.

CHAPTER II

THE CHEMISTRY OF CREDIT

The Fundamentals of Trading.—Trading is fundamentally an exchange of values. Satisfying one's desires when possessed of sufficient values to induce transfer of the things wanted, composes one of the most elementary contacts in human relationships. Imagination is strained by the effort to comprehend the innumerable currents through which goods and their consideration circulate. Standards of living have been raised; wealth has increased at a remarkable pace; scientific research has been encouraged; universities have been built; and the world drawn closer together by the simple process of an individual satisfying his needs and desires, multiplied innumerable times.

A clear appreciation given to this modern drama of trading demands a realization of how trading spread from its infancy through its youth to the maturity of present days. When the wants of the people were meager and society was not sophisticated, it was a natural procedure to exchange some commodity of equal value for the thing needed. There could be nothing fairer than to give goods for goods on an equal measurement of values.

Trading by "Barter" and "Money."—The sheep grazer and the grain planter could come together and satisfy their needs by exchanging the commodities they possessed. Barter has persisted in an inconsequential way to the present time, and as a natural basis for trading will always exist to some extent. The farmer will find it more convenient many times to satisfy his needs for groceries and wearing-apparel by exchanging his produce for them rather than by paying in money.

No extensive argument is needed to show how perfectly unadaptable this original method of exchange was to a society becoming sophisticated and among peoples with rapidly increasing needs. Something had to be devised that would facilitate exchanges when the tendering of goods was impossible. In no field of human contact has the legend, "Necessity is the mother of invention," been more vividly demonstrated than in the business of satifying human wants.

The necessity of having something more adaptable than the exchange of goods for goods to induce the circulation of commodities led naturally to the conception of a medium called "money." This medium is such a commonplace phenomenon in modern days that the idea of tracing its origin, its uses, and adaptability seldom arouses interest. Money had to meet in its chemistry the same qualities that existed in the barter basis of exchange. When the seller of goods accepts money in payment of them, he may not need anything when the transfer is made, but the money must assure him that when he does it will secure just as much value as he gave in the first transaction. There is no definition of money for trading purposes more appropriate than "suspended buying power."

It has been a perfectly natural evolution that money in its real significance, not the many forms of currency that we commonly call money, must be minted of a material that is universally acceptable, easy of carriage, and which resists deterioration. When meeting these three conditions, money offers a convenient substitution for goods in trading, and permits a more active exchange of values than barter.

The original basis of exchanging value for value was fully preserved in this second medium of exchange. It was merely giving to the seller the means of satisfying his wants immediately or in the future rather than accepting for the goods he sold other goods that he may not want. The peculiar properties of money facilitated trading in the handicraft period of industry. The precious metals were found and minted in sufficient quantities to satisfy the limited zones of trading that existed until the dawning of power production.

Credit as a Medium of Exchange.—The distinguishing feature of barter and money as exchange media was inflexibility. They did not possess the agility needed in a medium that would encourage active trading and large production. When industry was beginning to break all former traditions and to step out with vigor, necessity again intervened and revealed that credit could be made a commercialized system of exchange.

In the barter and money exchanges value is transferred for value, but in the exchanges of the credit system there is a transference of value for a representative of value. This new medium comprises two steps: first is the transference of value for credit; and second, the conversion of credit into real value. Thus the barter and money bases of exchange are preserved, but not in one gesture. While the completed transaction of receiving value for value given depends upon the conversion of credit into value, yet the transfer in this exchange transaction is consummated fully when credit is accepted by the seller. The intangible nature of this medium permits conditions that will defer the complete transference of goods from seller to buyer until the credit consideration has been converted into value. In the absence, however, of expressed conditions or of legal limitations, the transference of goods is just as complete in the credit exchange as in the money or barter exchange.

The rapidly increasing use of credit since its adoption as a commercial system is one of the most remarkable of our modern developments. Performing the same services as money, credit is used to effect more than 90 per cent of the mercantile and financial exchanges. Having proved its usefulness to unlimited business expansion, it is important that its beneficiaries study the chemistry of credit.

Each disastrous episode in our own financial history reveals but one fundamental reason—misused credit. The intangible nature of credit and the ease of minting it for commercial and money exchanges lead easily to serious abuses. Ignorance will largely account for these abuses, and even at present, with credit exchanges at their highest peak, the thesis can be easily supported that of all the factors comprising our commerce, none is so little understood and so superficially studied as credit.

The chemistry of money reveals certain elements making it universally acceptable, aside from the intrinsic value of its metal content. Likewise the chemistry of credit reveals elements that cannot be submitted to material measurement. The content of a gold dollar cannot be defined by merely terming it "a medium of exchange." The content of a credit dollar cannot likewise be defined by terming it "a medium of exchange." There is a difference between the contents of these two media and the exchange services they perform; definitions of credit have been confined largely to its uses and not its content, to what it does and not to what it is. When goods are bought for money, the real inducement for this exchange is not the buyer, but the money tendered. When goods are bought on credit the formula is reversed; the exchange is induced by the buyer and not by the tender of an immediate value. Much of the confusion that prevails in using credit results from a confusion of its real content with the service it performs.

What Is Credit?—Answering this question by describing it as a medium of exchange, as giving value in suspense for immediate value, of exchanging a promise for goods or money, are not descriptive of the elements that adapt credit to these important uses. Many years of survey and research in the credit field have not revealed to the writer a more comprehensive description of the credit content than a "human power." When the transfer of goods or money can be induced by the credit of the buyer or the borrower, no immediate exchange of value has taken place, and it seems indisputable that a human power brought about a transference that in its first step was not for equivalent value. The elements composing credit are spiritual and material. No human power could be otherwise constructed, and it is natural that a power generated in such a crucible should be one of the most dominating powers in human relationships.

The first step of the credit transaction—exchanging goods for the promise to give equivalent values at some later time—is complete in itself. But the second step in the credit transaction—to convert the promise into real value—determines, in its fulfillment or non-fulfillment, whether or not the exchange has been equal for both parties. A measuring-rod has been constructed by examination and experiences to determine whether the credit offered in mercantile and financial exchanges is of the proper chemistry; this measuring-rod has been popularly designated as the "Three C's of Credit," which are the measurement of credit's spiritual and material elements. They are "character, capacity, and capital." They are the foundation of the exchange medium that flows in such large streams and has permitted the building of commerce throughout the world to a surprising magnitude.

The Three C's of Credit.—There is a strangeness about credit and its expansive uses because of its foundation in these human elements. Consider how delicate the operation is of accepting goods or other values on a mere promise; the commonness of such transactions has hidden largely this extreme delicacy. The promise tendered is no better than the promisor; the intent back of the promise will have a great deal to do with its redemption, and the absence of character as a foundation to the transaction makes it highly dangerous and surrounds with doubt its final completion.

(1) *"Character,"* as a spiritual power of man, defies description; whether or not a person really possesses character is difficult to ascertain. In credit transactions, reputation is largely made synonymous with character, though often there is a difference between the two. Were the credit offered in a purchase or loan to lack this element, it should not be accepted, nor should it pass current any more than a gold coin that has been clipped or sweated. The composition of credit demands the presence of character as one of its dominating elements. It will not serve alone to redeem the promise or close the second step of the credit transaction, but without it the credit offered is unfair and usually worthless. The currency of credit rests upon confidence in its eventual redemption, and the expanding uses of credit show conclusively that most people have valued their credit powers and protected its character element.

(2) *"Capacity"* is an indispensable element in the minting of credit dollars. It is difficult to define clearly but it is a quality that can be developed in an adaptable person. Character, as the moral element in credit, is much less flexible than capacity, and is much less susceptible of construction. This second "C" appeals in the strongest way to the genius of credit management, for when there is adaptability to the building-up process, capacity can be cultivated under the guidance of good tutoring.

The term capacity, as related to credit, does not mean an ability to do almost anything as a "Jack of all trades," but refers distinctively to the development of the innate ability to merchandise in such a way that credit obligations are in no danger of becoming worthless.

The beginner in a business enterprise is supposed to start with at least some capital, and his capacity to handle this well will be demonstrated by the methods of his buying and marketing. Converting money into merchandise is a much easier task than reconverting merchandise into money at the original cost plus a profit.

If capacity were not needed in the conversion of money into goods and their reconversion into money, there would not be the daily failures which entail losses of such great magnitude. The ease with which merchandising can be entered into, and which results in constant failures and disappointments, has led careful observers to a belief that it might be advisable in the interest of public economy for the state to require a test of training in merchandising as it does for the major professions. The entire freedom that exists for anyone who elects to enter the merchandising field, or who is permitted to do so by distributing houses, places a grave responsibility upon credit departments to determine by acid test whether the applicant for goods or for loans possesses capacity in a sufficient degree to insure a proper liquidation of the proposed credit.

The responsibility resting upon credit management in this important feature cannot be overrated. To deal indifferently or superficially with appraisals of capacity may not alone prove damaging to oneself, but may be exceedingly unjust to the applicant who has not recognized or been told of the hidden dangers in merchandising when capacity is not possessed in the proper degree or when it cannot be developed.

Estimating, by careful and critical analysis, the capacity element of a credit risk calls for such use of the reasoning powers and is so incapable of being exactly measured by fixed rules that the operation is one of the chief reasons for designating the management of credits as "professional" work. Though capacity is undeveloped in the applicant when an approach is made for credit, yet if adaptability is shown, then getting under the adaptability and training the applicant for the game of merchandising offers one of the finest and most fertile fields to credit departments. To refuse an applicant merely because he lacks capacity at the time, irrespective of his adaptability and willingness to cultivate it, is no more just or germane to good credit management than to cast a person aside because of physical defects which may be curable.

The real sportsmanship in credit management and its real merits rest in the largest way on the exercise of skill in discerning the possibilities of a credit applicant when little or no capacity is discernible or has been demonstrated in his merchandising operations. Capacity to merchandise well—which can be reduced to the terms of merchandising for profit—is the goal of business, and the absence of this skill or the unadaptability of the applicant to its cultivation is a serious defect in credit, and to this defect the major part of our commercial failures may be attributed.

(3) *"Capital"* is the material element of credit. It is much easier to ascertain and to measure than the first two elements. In the minting of credit, character and capacity are comparable to the metal content of money, and capital gives toughness to these elements, it is insurance against deterioration and the cushion on which character and capacity rest. Capital, in some proportion, is a necessary element in every credit dollar put into circulation. Capital represents the stake of the entrepreneur in his business venture. Whenever it happens that the financial risk of the debtor is less than the financial risk taken by his creditors, then the goodness of the credit rests in a large way on the first two "C's" and we term it, therefore, a "moral risk."

When an enterprise becomes seasoned the capital element becomes of increasing importance and the investment of the owner of a business should be larger than that of his creditors. The capital element in its various phases offers a most interesting study for the credit manager, and a fairly accurate measurement of this element in a credit risk is usually sought by certain tools of the credit manager which will be elaborated upon in a later chapter.

A good banker of Philadelphia added in recent years a fourth "C," "collateral," to credit. From the viewpoint of the banker, this feature in credit transactions would have naturally a strong attraction, but upon an unprejudiced scrutiny of the idea there can be found no reason for the addition of a fourth "C" to "credit chemistry."

In collateral transactions dependence is usually placed on the collateral offered and not on the applicant. The collateral itself will be either a credit transaction or a certificate of partial ownership in some enterprise. The collateral should measure up to the test of the three "C's" for acceptability, and though strong arguments may be advanced in banking circles for the addition of the fourth "C" to credit, a close analysis will not justify it.

The Chemistry of Credit.—The three elements—character, capacity, and capital—in their separate aspects are like the metal and the alloy before they are minted into coins. The value of the coin is measured by its metal content, and the stamp of the government on the coin is the assurance that it contains the proper number of grains of fine gold and the proportion of alloy to give it the designated exchange value.

No rule has or can be fixed for the proportion of the three elements that assure for the credit dollar a value equal to the value for which it is exchanged. But credit, to offer a fair exchange, must contain the three elements; to be beyond unpreventable risks of depreciation it must contain the three elements in proper proportions. Observation and experience lead us to believe that of the credit in general circulation the smaller part contains a full proportion of the three elements that go to make a perfectly safe risk.

This feature and the fact that the three elements may change quickly from unexpected causes or emergencies, require a skill in the minting of credit dollars that only persistent study and training can cultivate. With ultimate liquidation as the objective and with the risk usually incident to credit transactions, building the ability to appraise in what proportion any of the three elements may be missing from the credit without involving reasonable expectations of its ultimate liquidation, should be the aim of credit management.

The applicant for credit may display a capacity for merchandising and a sufficient cushion for the risk in capital, but his record for fair dealings may be poor. His actions outside of business may show lack of moral stamina; his character may be in other ways impeachable. Will it be reasonable to accept the credit of such a person and expect its ultimate liquidation without any impairment of value? If a risk of this nature is taken without condition or security it is a gambler's chance; should the risk fail, the credit department accepting it must concede that a poor quality of credit had been minted.

The absence of character in the composition of credit may be called a serious defect and is as much a danger signal to the credit manager as a red light to the engineer.

An applicant for a credit transaction is found with an unimpeachable character. He may be arranging to open a new business, and the investment he proposes to make may look sufficient as a warrant for the risk. If his business has been a going one, the net investment in it may show on paper some increase of the original investment. Upon careful examination, however, there is nothing about the applicant to warrant the belief that he possesses merchandising ability or is adaptable to merchandising. His previous efforts have been in other fields, or the nature of his financial showing may indicate that the business has lacked the driving power of merchandising skill. The absence of this element or the unadaptability of the applicant is a fatal defect in a credit risk; should credit dollars be minted with this element lacking, they will be found usually short weight and eventually worthless.

Character cannot accomplish for an enterprise what capacity must. Character will not lead the way to good buying and profitable marketing. It may point out to the debtor that his undertaking is hopeless, and it were better for him to retreat from the game before the investments of his creditors are imperiled. The credit dollar can well spare for its currency and redemption a larger proportion of capital than it can of capacity. Capacity is the mystic element of credit and upon it rests in the very largest measure the eventual accomplishment of what credit is expected to do. Character and capacity, when joined, furnish a content for credit that will give it assurance of value and final redemption. The joining together of character and capacity in proper proportions will eventually add of their own powers the third element, capital.

Good Judgment in Credit Management.—Good judgment in credit management has no wider field than determining in what proportions these three elements should be found in a credit risk. This, in an inverse fashion, may be expressed by saying that the good judgment of credit managers has its widest play in determining to what extent any of the three elements may be missing without imperiling the eventual redemption of the credit.

Money as a human invention filled a human necessity. It was found superior to barter in the evolution of society and in the expansion of trading. Granting the superiority of credit as an exchange medium in big business operations and large financial transactions, the question naturally arises, What are the qualities of credit currency that have made it so much more adaptable to present-day conditions than money possibly could be?

Credit has been found adaptable to expanding business. If money had been able to do what credit has done, there is no reason to believe that credit would have passed beyond its initial and very simple stages.

At present our currency which we call money in actual circulation approximates four and three-quarter billion dollars. In a recent week when heavy liquidation was taking place on the stock exchange, the checks charged to individual accounts by reporting banks reached the stupendous sum of twenty-eight billion dollars. The clearances each year as reported by the clearing houses approximate seven hundred and fifty billion dollars, and yet our entire monetary gold stock is four and three-quarter billion dollars.

If it were necessary to conduct the exchanges on a money basis, these operations would be necessarily limited to the amount of money available. The genius of credit and the quality that has made it so adaptable to big business is its "flexibility" and "clearance powers."

The Flexibility and Clearance Facilities of Credit.—The credit dollar, unlike the money dollar, is expected to circulate for a limited and specified time only. Its liquidation is the real essence of credit, and without liquidating capacity the thing created is not a credit, but a waste. The economy in credit circulation rests upon its clearance powers.

An unlimited number of persons may owe one another a hundred dollars. The first debtor need not pay what he owes to his immediate creditor, but by paying one hundred dollars to the last creditor in the line all of the indebtedness comprised in the intervening transactions will be extinguished.

Checks aggregating many millions of dollars flow daily into the clearing houses, and after comparing what the banks included in the clearance operations owe or are owed by one another, the balance needed to liquidate these obligations is small in comparison with the total sum represented by the checks cleared.

So long as credit circulates in this way and the credit dollars extinguish one another by being cleared against one another, large operations in production, marketing, and finance can be carried on with a little available money. As a matter of fact, in these modern days when credit has become as common as the atmosphere, money is not used generally except for the payment of balances, wages, and for pocket purposes.

The atmosphere of credit must be uncontaminated. The important element of the credit atmosphere is confidence, and when this element is affected credit becomes impaired, liquidations become irregular, and though the elements of credit are present in proper proportions, yet their usefulness is impaired by the absence of confidence. No finer or more constructive appeal can be made to credit management and to users of credit in trading transactions than to have a workable knowledge of credit chemistry. The tendering of credit is a delicate operation involving the good faith of the buyer and the good judgment of the seller. The credit transaction is not complete until the credit is redeemed with real value, and this is the feature which is called the "credit risk."

CHAPTER III

THE VARIOUS TYPES OF CREDIT

Minting Credit.—There is an appropriateness in using the term "minting" in relation to credit—as much so as in relation to money. Credit assumes various forms in its circulation. The credit may be expressed in writing or it may be implied from the transaction out of which it arises. Credit resolves itself into two general classes, "public" and "private." "Public credit" represents the credit of governments and political units exchanged for loans and goods needed and in the carrying out of governmental functions and obligations. "Private credit" represents the credit exchanges of organizations, corporations, partnerships, and individuals for goods or loans needed in the carrying on of business enterprises, industrial production, the satisfying of individual wants, or other purposes of a private nature.

The various credit dollars minted in public and private transactions do not differ as to content. The government that borrows money or purchases goods must be appraised by the same yardstick that is used for measuring the credit capacity of the humblest citizen. A government cannot furnish the proper elements of credit if its paying record is not good; if it has defaulted on its obligations; if its sources of income are inadequate. The character of a government is its record in dealing with creditors; its capacity is reflected in the economy of its operations, its capital in taxing powers and public property. From the beginning of our government in 1789 until the present moment, its obligations have always been taken care of dollar for dollar. Defaults have never been found in its fiscal operations, and thus it is that the credit of our government will be accepted everywhere on the very best terms.

Other nations have not been so fortunate. Mexico, for instance, finds it very difficult to borrow because of defaults and the insufficiency of incomes. Its credit can be put into circulation only at large cost and on expensive terms. The reader must understand that no matter what the form may be into which credit is minted, its content and its risks do not change.

Types of Public Credit.—Usually public credit takes the form of a carefully defined contract, the terms of which are set out in the credit instrument. Where governments operate under constitutional provisions, their credit contracts must be in accord with these provisions or they are not enforceable. Public borrowing is usually done in accordance with legislative action, and the legislative bodies in authorizing loans and purchases must have the proper warrant. The instrument used for setting out the terms and conditions of a public credit has not a uniform terminology. The "consols" of Great Britain and the "rentes" of France are instruments of governmental borrowing. Our federal government, for long-time borrowing, designates the exchange instrument as a "bond"; for short-term borrowing, "certificates of indebtedness." The name, however, is merely an incident, and those willing to accept public credit in exchange for their money or their goods need only to satisfy themselves that back of the instrument are the proper elements of credit and adequate legal authority.

Types of Private Credit.—Private credit is subdivided into four general types, known as "investment credit," "bank credit," "commercial credit," and "individual credit." These general types are descriptive of the particular fields for which credit is minted, and once again emphasis must be placed on the fact that these types represent merely the denominations of the credit coins and no variation as to their content.

(1) *Investment Credit.*—Under this general descriptive term is that form of exchange where the loan is made for investment or for speculative purposes. Under this type may be placed the bonds and certificates of indebtedness issued by corporations for borrowing purposes. The bond is an instrument by which the credit of the corporation is exchanged for the money of the lender; the bond must have a definite maturity;

it must set forth the conditions of the loan, and it must be legally authorized. The purchase of bonds and certificates of indebtedness for investment or speculative purposes has become so common that the credit nature of these transactions is seldom thought of. Purchasing stock in a corporation differs from a purchase of its bonds because the purchaser of the stock becomes thereby a part owner in the corporation. The purchaser, with the other owners, assumes the risks of the corporation; he has not made a loan to the corporation and there is no definite maturity to the certificate he holds. Investment credit is clearly distinguished from the other forms of private credit both as to purpose and to the manner in which the credit is expressed.

Before proceeding to describe other types of private credit an interjection must be made. This and the previous chapters have clearly set forth that in transactions on credit terms for the goods of the seller, or the money of the lender, there is exchanged the credit of the buyer or the borrower.

Custom has brought about the use of the term "credit-granting," when as a matter of fact this term misrepresents the transaction. The use of this term, however, has become so interwoven into modern business and finance that great confusion might occur were an effort made to substitute a term accurately descriptive of the transaction.

Obviously, the seller does not give the goods and the credit also. Credit is given by the buyer in exchange for the goods, and by the borrower in exchange for the money. Many mishaps in credit practice might have been prevented if there had existed a more accurate terminology for credit exchange transactions. Irrespective of the terminology, users of credit, managers of credit, and students of credit cannot grasp the real significance of credit currency except by holding clearly in mind the exact nature of the transaction.

(2) *Bank Credit.*—Holding in thought the foregoing explanation of the improper description of the credit transaction, bank credit is in reality the credit offered by banks in exchange for deposits. Though the bank is merely a custodian of the deposited funds, yet the transaction is of a credit nature, par-

ticularly so when the deposit is made with the understanding that it shall not be withdrawn until after a specified time. In the deposit transaction, the bank's credit is exchanged for the funds deposited. In general usage, however, bank credit is descriptive of the loans made by banks in their operations. The credit transaction of the bank and borrower is expressed usually in an instrument called a "promissory note." The bank accommodation may also be expressed in the discounting of notes or drafts executed by debtors of the borrower. While it is not good banking practice, sometimes banks will permit depositors to overdraw their balances. Such accommodations, however, are of a very temporary character.

The Federal Reserve Act granted to member banks the privilege of accepting drafts arising from domestic or foreign transactions. The "bank acceptance" is a private credit instrument of the highest character when the accepting bank is financially sound. The right to accept drafts under reasonable limitations and to purchase the acceptances of other banks has given a very useful flexibility to "bank credit." "Letters of credit" for tourist convenience and for commercial transactions are another form of bank accommodation of a credit character. In the field of private credit there are no forms of higher standing and usefulness than the instruments of bank credit. The simple loan transaction is merely an exchange of credit for the accommodation. The acceptance transaction is an exchange of credit for an accommodation in the form of an acceptance of a draft or bill of exchange.

(3) *Commercial Credit.*—This particular field of credit transactions offers to the student a wide variety of forms of usefulness and circulating value.

The Open Book Account.—This is the most common form of commercial credit. It suffers the most serious shrinkage and lacks the circulating value that a minted credit dollar should possess. It was thought, in the days of disordered finance following the Civil War, that credit accommodations, to encourage the flow of merchandise, had to be of long duration, and that they could not be expressed in the form of absolute promises to pay on fixed dates. Instead of receiving from a buyer of merchandise a credit instrument stating the consideration and maturity of the contract, a ledger charge was made showing the amount of the purchase and the terms of sale. This form of credit has made it perfectly natural for buyers to purchase or order goods and say nothing about paying for them. Their promises are implied when the terms are stated; in many instances the buyer merely says, "Charge them," when making a purchase or ordering goods. This form of credit differs from all other forms, and except for the accommodation the open book account gives to the buyer, its qualities are open to most serious question.

Take in illustration this comparable fact: a bag of unminted gold has the same value as a similar weight of minted gold. If the owner of the unminted gold wants to exchange it for things he needs, the transaction would not be effected until the gold has been weighed and its exact value ascertained. Minting the gold into coin gives it circulating value, and exchanges can then be effected without question. The form in which the gold is tendered measures the dispatch and convenience in using it.

The open book account is like unminted gold. Its content, the deserving qualities of the debtor, may be as good as though the credit had been minted into an instrument that would circulate freely. The open book account has no circulating value as the written credit instrument has, and it is subject to equities and conditions that make it the least usable of all credit forms and the most susceptible to depreciation.

Should the seller of merchandise have a written promise of the debtor to pay in negotiable form, he possesses something that can be used for borrowing purposes and for the liquidation of his indebtedness by his indorsement of the promise. This is not so with the open book account. It is perfectly static. The creditor in a pinch may be able to borrow on the account by pledging it with a bank or finance company. This pledge, however, is not a transfer of the account. The debtor need not recognize the pledge in liquidating the account. Its transference can be accomplished only by notice to the debtor. If used as a pledge, or if transferred with the debtor's knowledge, the open book account is subject to any claims the debtor may have or fancy he has against the creditor in the particular transaction. Should the debtor find that the goods were not of equal value to the samples from which purchase was made, he can enforce his claim for damages or he may elect to return the merchandise, no matter whether the open book account has been retained by the creditor or pledged or transferred to some one else. Should the credit have been expressed in the form of a negotiable note or negotiable instrument, its transfer by the payee to a third party for value received relieves the instrument from the equities of the maker or acceptor, and he can enforce his claims only against the seller. The instrument in the hands of innocent parties must be paid.

The open book account has decided disadvantages other than the absence of a circulating value. The open book account naturally leads to settlements beyond the maturities of purchase contracts. This form of commercial credit is subject to considerable shrinkage in the liquidation of business enterprises. The ease with which claims may be set up against them, the ease with which terms may be abused, the ease with which capital may be too largely tied up in this non-circulating form of receivable, constitute real dangers and risks which have strangely persisted in this most enlightened period of our credit commerce.

The Discount For Cash.—In the days when this form of commercial credit seemed to be necessary and when bank capital had not advanced far enough to finance large commercial transactions, the expedient was devised of offering a premium for cash payments—a device known as a discount for cash. Rather than carry open book accounts for six months or a year, the selling houses were willing to allow a liberal discount for payment within thirty days or less. The risk of long-term credits required long profits and it was safer and good business upon the part of distributing houses to allow a very liberal discount, as high as 6 per cent and 7 per cent within ten or thirty days from shipment or the dating of the invoice. This device of the discount for cash has continued with the open book account, though in some lines sales are made on a strictly net basis.

As banking resources expanded and loans were available in larger sums to finance mercantile transactions, the discount for cash decreased, as did also the average time granted for the payment of bills. The open book account as a form of credit is not only subject to depreciation and shrinkage from various causes, but the discount for cash has been in all probability one of the most abused devices for the attraction of payments. Seldom is the remittance received by a creditor on the day that the discount for cash expires. The remittance may be made on that day by the debtor or within a few days thereafter; and should the creditor offer objections or decline to accept the payment because of lateness, unpleasantness is apt to result, and altogether this type of sales term has, since its inception, been prolific of unjust deductions, of ill-feeling, of various unpleasant threats, and loose principles. The open book account is really anomalous as a form of credit, for it has no currency powers and the creditor cannot ever tell absolutely what it is actually worth.

Negotiable Promissory Notes and Drafts.—Negotiable promissory notes and drafts are forms of commercial credit that are usually resorted to for special purposes or reasons. The general usage of the open book account in mercantile transactions relegated these negotiable instruments largely to situations where open book accounts had become overdue, and as an accommodation to the debtors the accounts are extended by promissory notes. The using of these negotiable instruments coincident with the delivery of merchandise may happen in special cases where the credit of the buyer is not entirely clear or they are given as an accommodation to the seller. The debtor may be willing, after the maturity of his account, to accept a draft of the creditor, payable at a fixed time from date of the draft or date of acceptance. These negotiable instruments, as forms of commercial credit, have not been used as they should have been in perfectly fresh transactions because of the open book account custom in mercantile transactions. The credit of a buyer should be in a form that the seller can use and rely upon and not in an unminted form where value and maturity are uncertain. To bring this about and to lessen the dependence on discounts for cash, the Federal Reserve Act, among its many benefits to our credit technic, created a new form of credit designated as a "trade acceptance."

Trade Acceptance.—Many decades ago, and before the open book account became a popular expedient for the encouragement of sales, acceptances largely prevailed in mercantile transactions. The new form authorized by the Federal Reserve Act differed from the older instrument in that provision was made for an express statement on the face of the acceptance that it arose out of a concurrent sale and delivery of goods. It was this provision, indispensable to the instrument, that gave it the term "trade acceptance." The idea was that when merchandise was delivered on executed order, a trade acceptance, for the amount of the invoice and maturing in exact agreement with the time allowed for the payment of the goods, would be forwarded with the invoice, accepted and returned to the seller when the goods had been received, and checked against invoice, or even before, if there was complete confidence in the seller's reputation.

The instrument also made the business of the seller more fluid and less dependent upon outside accommodations. In order to secure funds owners may resort to the expedient of borrowing on their open book accounts secretly and when unable to obtain accommodations from banks. As a book account cannot be transferred without notice to the debtor, this secret form of borrowing is entirely by a pledge of the account, and because of the risks attached the costs of this kind of financing are much larger than are the costs of bank accommodations.

The custom exists in some industries of transferring book accounts to factors. In these lines the debtors are requested on rendered invoices to remit to the factors and not to the selling houses. There was great promise of fluidity in commercial credits through a general use of the trade acceptance. As a negotiable instrument, it bears upon its face the acceptance of the debtor and can be transferred or discounted by indorsement of the drawer. Two names thus appear on the instrument, making it a much stronger type of credit than the promissory note used in bank accommodations, which bears usually the name of the maker alone.

Yet the trade acceptance has met with difficulties from the start. To encourage the substitution of the trade acceptance for the open book account and to expand the knowledge of its intrinsic merits, some prominent bankers and credit executives in New York City organized a "trade acceptance council," which title was later changed to the "American Acceptance Council." Though persistent efforts were made to bring about general use of the trade acceptance, the open book account was so deeply imbedded in commercial credits that it could not be rooted out, even in a moderate way. Many wholesale houses feared this new type of credit would cost them business if it were not adopted by all of the houses in their particular line. In certain trades where shipments were frequently made, objections were offered of the difficulty in closing these small and frequent shipments by trade acceptances. The instrument was not to be used except in fresh transactions; if it were used for closing overdue accounts, then its intentions were roundly abused and the trade acceptance became in reality a falsehood. Despite the good faith that the instrument should inspire throughout the body of business, numerous instances developed of serious abuses. These discoveries increased the difficulty of using the trade acceptance as it was intended by the Federal Reserve Act. As this chapter is written, the trade acceptance has grown in mercantile transactions only slightly. But until it or some equally good type of credit is substituted, the open book account will continue as a static form of credit with many inherent dangers.

(4) *Individual Credit.*—This form of credit is more often designated as retail credit. It represents the exchange of retailers' goods for the credit of individual buyers. It is sometimes called "consumption credit," for the reason that it is used to satisfy the wants of individual consumers. This type of credit ranks the lowest of all credit forms, not for the reason that individuals may not be just as much entitled to the exchange as the retail or the wholesale merchant may be in commercial credits, but because, theoretically, credit is intended for

constructive and not for consumptive purposes. When goods are bought by a wholesaler of his supply factory on credit, and these goods are in turn sold to retail customers, the credit of the wholesaler with his supply houses is supposed to be automatically extinguished. In this process the credit is used to finance the movement of merchandise through various hands. When the retailer sells the goods to a customer on credit, the goods may be entirely consumed before the credit is redeemed or they may be so far consumed as to lose their base for the transaction.

In liquidation the receivables of a wholesale house will usually shrink less in the collection process than the receivables of a retail house. In large cities the shrinkage in liquidating individual credits will be less than in liquidating the receivables of a country store. Throughout our rural sections, when failures happen and merchants pass through bankruptcy or have their affairs adjusted by friendly process, the receivables representing individual purchases shrink largely. In many instances they will not liquidate beyond one-quarter of their face value. The individual credit is generally in the form of the open book account. Settlements may sometimes be effected after the maturities of accounts by promissory notes, but the deviation from the open book account in individual credits seldom happens.

This presentation of the various types of credit minted for borrowing or buying purposes would not be complete without an incidental reference to loans made on the pledge of real estate, known legally as the "mortgage." Lending to "building and loan companies" in exchange for their certificates of indebtedness is another type of credit. In reality, both of these types should be designated as investment credit. There may be other forms of credit in use, but the types described in this chapter are the more common in mercantile and financial transactions. Differing so largely from minted money, having characteristics and contents the antithesis of money, credit serves the same purposes and does it with greater celerity, convenience, and flexibility.

CHAPTER IV

THE USES AND ABUSES OF CREDIT

The Uses of Credit.—The primary use of credit is to transfer capital from those who have it to those who can use it profitably. In our historic chapter the Phœnician adventurer was pictured as needing goods for a trading trip. His supplies were presumably procured from producers or merchants upon agreement that the goods intrusted to him would be paid for from the proceeds of the trading trip. This allowed the trader to accomplish something that otherwise he might have been unable to undertake. Credit was the medium that effected the transfer of the capital goods, and when the trader met his obligation the credit transaction was concluded. The prices agreed to for the goods doubtlessly included a premium for the credit risk.

The profits obtained from the venture were made possible by the credit agreement; the supply houses would derive profits from the transaction and so credit allowed the earning of double profits. Multiplying this simple transaction innumerable times explains the rapid rise in wealth and importance of certain trading peoples at the dawning of modern commerce. Passing to present-day commerce, credit as a transferrer of capital may be illustrated by a common business episode.

A venture into the retail field is contemplated. The capital possessed by the adventurer is not sufficient to produce a volume of sales and profits that would cover the overhead costs. To supplement the capital available, credit will serve to transfer goods or loans, which will give to the venture facilities for securing the sales and profit volume that will keep intact the owner's investment and permit the prompt return of the capital borrowed. Credit, obviously, in transferring capital is attended with risks for which it is proper that a premium should be paid. For the debtor, the accommodation of credit postulates the opportunity to make profits on the capital of others, and for such accommodation some consideration should be allowed in the price.

The old school of retail merchandising has been thrown into confusion by some modern stores selling alone for cash and making a distinction in prices because there is no credit risk.

The premium charged for the credit risk is but a portion of the profits a business enterprise should earn, so that its powers to liquidate credit obligations are never in jeopardy. Producing, buying, and marketing in a manner sufficiently skillful to protect the original investment and add a little year by year are hazards for which a reasonable premium is deserved.

Domestic Trade.—Domestic trade is that domain of merchandising confined to our continental boundaries. Within this field raw materials are moved from mines, mountains, and fields to fabricating plants. Finished products are moved on to wholesalers and merchants, and the retailers purchase these products for resale to consumers. Credit keeps these goods in motion, from their raw state to consumption. The domestic trade of our country in 1928 was at least 90 billions of dollars. More than one-third of this domestic trade was accounted for in retail merchandising. Our stock of money in actual circulation during 1928 did not exceed 5 billion dollars. The ability of credit to finance our domestic trading is patent, and without its exchange powers such a large volume of domestic commerce would not have been possible.

Foreign Trade.—The wide expanse of our domestic field and the success we have attained have kept us, largely, from realizing the merits of foreign trade. From the beginning of our national career, products we could not consume at home were shipped abroad, and this export trade enabled us to pay for the goods we could not produce ourselves. Until six decades ago the export portion of our foreign trade was almost entirely made up of raw materials. With the rise of our industrial energies twenty-six years ago, selling finished products abroad became a part of our marketing program, and its fruition was reached in the World War period. From less than 25 per cent in 1900, finished goods now constitute more than one-half of our exports. The present sum of our foreign trade, approximating 10 billion dollars for the present fiscal year, deserves the nation's respect.

Credit facilitates exchanges in foreign trade as it does in domestic. The types of credit generally used in foreign exchanges are more formal than the types used generally in domestic credits. The merchant in California may buy in New York City on open book account terms; the merchant in Brazil will buy in New York City on some written evidence of the credit transaction. The credit instrument used in the foreign transaction is generally an acceptance or bill of exchange. The open book account is sometimes used in foreign credit sales, but such a type of credit is even less desirable in foreign trade than in domestic.

The Bank As a Reservoir of Credit.—The commercial bank expresses one of the most useful evolutions of modern credit commerce. The essence and vitality of the commercial bank is credit. The forebears of this modern banking institution may have been the "Goldsmiths" or the "Lombard" money dealers; these early money geniuses discovered that it was usually safe to lend portions of the moneys intrusted to them, and by keeping a small reserve they would have sufficient to meet the ordinary demands of depositors. This was a useful discovery; it opened up new uses for credit and became the keystone of the great arch of modern banking.

The commercial bank has grown to be an indispensable servant to business by becoming a depository of capital not in use, and transferring deposits to borrowers who can use the capital in proper and profitable ways. These transfers can be safely made by reserving a small portion of the deposits against the daily demands of depositors. This reserve ratio within the borders of safety has decreased as our knowledge of credit has increased.

The Federal Reserve banks are required to have reserves against demand liabilities much larger than the member banks of the system. Experience has shown that such a graduation of reserves is entirely safe even though commerce at times is apt to get beyond normal bounds. Banks have been described by some writers as manufactories of credit, but this is not their real function. The commercial banks are *reservoirs* of credit. Capital in the form of deposits flows into them, and no more flows out than flows in.

The important part played by commercial banks in credit operations is shown in the reports made to the Comptroller of the Currency by our national banks in response to his last call. There were 7,473 banks operating under national charters. The deposits of these banks aggregated $21,901,997,000; their loans and discounts amounted to $14,961,877,000. The profound nature of the credit service rendered is reflected in these large totals, and to these must be added the operations of more than twenty thousand state banking institutions.

Credit is Not Capital.—There is danger, when describing credit as a transferrer of capital, that confusion may occur as to the real nature of credit in the transfer operations. The goods or money pass into the possession of the buyer or borrower on credit terms, but the terms imply that the capital of which he becomes the user must be returned sometime. Using capital and credit properly demands that their differing natures should be understood.

Non-commercial Uses of Credit.—Fundamentally, credit is an instrument of commerce facilitating exchanges in trade. Credit, however, is used also in non-commercial ways and at times in large amounts, and may be of long or short duration. It may be in the form of a book account, negotiable instrument, or a bond.

When governments use credit it is usually for non-commercial purposes. There arise in the operation of a government extraordinary demands which cannot be provided for from ordinary revenues. These emergencies will necessitate borrowing, frequently in huge sums. The United States increased its public loans from a little more than a billion dollars in 1913 to 26 billions in 1919.

Credit is used a great deal in other non-commercial ways. A home may be built by the proceeds of a loan based on the value of the property and credit of the borrower. Securities are bought on the same bases or on the credit of the borrower alone. Consumption goods not entering into commerce and with no reproductive value are bought on credit. The fact is frequently lost sight of in non-commercial uses of credit that the credit supply is never inexhaustible.

Installment Selling.—This form of marketing has in recent years grown very rapidly. For many decades one could purchase labor-saving conveniences on the partial-payment plan. The total of these transactions, as they were carried on formerly, occasioned no concern. With the advent of the automotive vehicle and of attractive entertainment devices, installment selling induced their widespread distribution and the volume of installment contracts rose rapidly. The installment sale is not a direct credit transaction. The buyer on installments has the use but not the ownership of the article; the transfer of ownership does not take place until the last payment is made. The article can be repossessed if payments are in default, and prior to repossession whatever payments the buyer has made will be regarded as rentals. The credit feature of installment selling is the discounting of the contract by distributors with banks and finance companies; in this indirect fashion installment selling is financed by credit.

The Abuses of Credit.—It is axiomatic that anything man may use, he may also abuse. Credit, in proper uses, is beneficial and a fine ally of humanity; when overindulged, however, credit affects the human welfare, creates disorders, arouses fears, causes confusion and failures. Abuses of credit frequently result because of ignorance, selfishness, and dishonesty. The highways of credit are not well marked; disasters often occur because users of credit lose their direction and are unaware of the hidden dangers. Accidents are innumerable because charts are missing showing how borrowed capital should be protected against hazards. Capital intrusted to anyone on credit terms who lacks the ability to use it profitably, stands grave chances of shrinkage or total loss; if transferred to anyone who lacks honesty or intends to pilfer, capital will rarely be returned.

The Debtor's Obligation.—When receiving value on a promise, the obligation of the debtor is to protect that value against all controllable hazards. The objective of the credit transaction is to use the goods bought or the money borrowed in such ways that it will be possible to redeem the obligation as agreed. Should the goods be resold recklessly and converted into receivables that will not liquidate, or should the money borrowed be used unproductively, a distinct abuse of the credit has happened and the creditor is apt to lose.

The buyer or the borrower has the right to use the capital of his creditor as though it were his own, but with the agreement that an equal value will be returned at a stated time. The goods or money are mingled with the debtor's, and his merchandising capacity is shown when this borrowed capital is used in the courses of the business so that there will be sufficient cash on hand with which to meet the obligations when due. The credit risk is a deficiency in this capacity to merchandise profitably and to meet obligations promptly.

Using Credit for Speculation.—Proper uses of credit in commodity transactions postulates movements from producer to consumer. Taking goods off the market for speculation against higher prices is dangerous, and such misuse of credit frequently exacts a heavy penalty. If prices rise, more credit is demanded to finance the speculative purchases and the process may continue until credit is so thinned that a breath will bring the pyramid tumbling down. In the immediate post-war period credit was roundly abused by commodity inflation; there seemed to be no limit but the sky to prices. This unhealthy situation demanded a supply of credit that wore down the Federal Reserve ratios almost to their lawful limit. The thin shell of this aggravated situation was pierced when the prices of silk and rubber began to tumble, and the inflated edifice came down with a crash. This frenzied use of credit cost business several billion dollars and caused a prostration from which commerce did not recover until 1923.

More frequently credit is misused in speculative buying of securities. As prices rise, more credit is needed to finance purchases; should the upward trend reach a point that indicates price inflation, then it is patent that the credit involved has become dangerously thin.

A limit is eventually reached in all inflationary movements—a point beyond which prices will not go without breaking the credit support. Such a disastrous episode in the securities market has happened recently. Security prices levitated until the returns on gilt-edged stocks were far too small for investment purposes. Loans to brokers were the largest of our financial history. Credit available for speculation grew very thin, and the bubble burst with severe losses. Fortunately, the Federal Reserve banks husbanded their credit resources; they did not give encouragement to the speculative orgy. When credit cracked and the scene was set for a veritable panic, the Federal Reserve banks were able to apply helpful measures and to bring about an orderly readjustment.

Credit Inflation.—The genius of credit is its eventual liquidation. To protect this liquidation it must never be used beyond the reasonable risks of business. When the assets of a business or the commodity on which credit is based are in danger of not realizing sufficient to redeem the credit, then there is credit inflation. The assets should be always sufficient to repay borrowed capital, as a going enterprise or in liquidation. To determine this credit guaranty, the current assets of a business are measured against its credit obligations. In noncommercial uses of credit, the base of the transaction should have sufficient spread to remove the hazard of a contraction in value below the credit involved.

If for every dollar of credit used currently there are two dollars of current assets, the margin is regarded usually as safe; as the margin increases, the safety of the credit obligation also increases. Should it be discovered that current assets and current liabilities balance, the situation is one of inflated credit, but when current liabilities exceed current assets, then credit has been badly used and there is no chance of its complete liquidation. Governments may inflate their credit by borrowing beyond their capacity to repay, or by using loans imprudently.

A strong appeal is made to good management to preserve the benefits of credit, to make clear its real benefactions when well used and its severe expensiveness when abused.

CHAPTER V

THE CREDIT DEPARTMENT AND ITS MANAGEMENT

The Responsibilities of the Credit Department.—The outstanding phenomenon of modern business is its operation and control by departments. When the era of "big business" was ushered in there came about a gradual substitution of corporate organization for the partnership plan, and it soon became apparent that a single mind or a very small group could not successfully plan, direct, and control the various functions of a large enterprise. Demarcations in the functions of an enterprise naturally took place, and departmentalizing resulted from this new order of things. This progressive idea in business control has been the mainspring of our rapid industrial progress.

In a business enterprise the purchasing department plays an important part in its success; purchasing raw materials and finished products in a manner that will produce reasonable profits is a task that demands training and executive skill. In an industry the production department is the base of its prosperity; goods must be produced well to sell well, and the management of such an important department must be well trained and skillful. The sales department is a major function in a business enterprise. Salesmanship is a type of work to which many aspire; it carries a popular appeal and is so important that its successful management calls for highest skill and congenial attributes.

The fourth major department of a business enterprise is credit. The question may be asked: What is the relative importance of this department to the successful conduct of a business? So many of its operations are intangible and unseen that its high importance and its responsibilities are not sufficiently recognized. The department protects the integrity of invested capital, and it conserves what the other departments have accomplished. Business can never escape credit entanglements until the credit department's responsibilities are clearly understood and granted the proper sympathy and support. Goods may be bought or produced with the finest skill and may be sold at fine profits, but not until the credit department has completed its task are the profits secure. Can it be said that fabricating attractive goods, good buying and good selling, are more important than the skill shown by the credit department in seeing that the goods are sold to those "who are able to pay and are willing to pay"? In submitting the financial statements of business concerns to a close analysis, it is easy to see how largely their net worth rests upon receivables; as a usual thing the loss of receivables would not jeopardize their solvency but would impair their invested capital.

The credit department is a crucible through which sales pass to determine whether the value of the goods sold may be expected reasonably from the buyers. In the exercise of this important responsibility the credit department acts as a protector of profits, and without profits it is axiomatic that a business enterprise cannot succeed. The opinion issues every now and then that business could function just as well without a credit department. The departments of a business constitute a system comparable to the human system in its major and minor organs; no one can say to the other, "I have no need of thee." To the success of the enterprise the credit department holds the same relation as a vital organ to human life.

The credit department has grown to importance in factory and wholesale and retail merchandising; there must now be added the field of finance, in which credits are almost entirely dealt. Before the turn of the twentieth century, the very smallest number of commercial banks in our country had well-organized credit departments. Loans were approved largely on personal knowledge and confidence, but today our largest commercial banks are using the credit department to distinguish between safe and unsafe borrowers to the same extent that mercantile houses are using the credit department to distinguish between safe and unsafe buyers.

Bringing the business mind to a proper understanding of the credit department's responsibilities is not easy because of the intrigue that production and selling have exercised, but marketing economy will never be fully attained until the credit department's responsibilities for directing the safe flow of goods and for conserving profits are fully recognized.

Location and Equipment.—Under the direction and control of an executive mind, the credit department will in all of its machinery and devices accord with good system and economy. Properly locating the credit department in an office or a bank is more important than appears upon the surface. The location should be in pleasant surroundings because the nature of the credit task is so largely mental that cheerless surroundings may affect credit judgments and bring about unwise decisions. There should not be any distinction between the treatment accorded the credit department and other major departments in their physical layouts. It would be foolish to place a purchasing department in the darkest part of a building. It would be equally foolish to coop up a production department in an unpleasant place. But for the credit department any location is frequently thought good enough, when from the delicate nature of its work no other department of a business will respond more productively to cheerful and pleasant surroundings.

Equipping the credit department for its various functions is the next feature to emphasize strongly. The filing cabinets and devices should be adequate, convenient, and fire proof; the records of a credit department are among the most important and useful that a business concern can assemble. Financial statements obtained from customers should always be preserved carefully in the credit department's files; the ledger clearances, mercantile agency reports, and other types of information about customers should be kept systematically and be available promptly to the department's manager.

Personnel.—Nothing ever proves costlier and turns out a greater failure than "to send a boy to do a man's job." The lure of production and selling has led to liberality in providing personnels for these departments; this disposition toward the sales department is overliberal at times and probably no marketing process has registered more failures and higher costs, but the credit department is too often neglected in the selection of its personnel. Good and profitable credit work is an expert's job, and unless the department's management is surrounded with a proper personnel there cannot result the efficiency in the department's operations which its possibilities deserve.

The various unfortunate experiences from misused credit in our financial history, and the losses seen and unseen occurring daily in the commercial field, clearly demonstrates the brevity of knowledge concerning credits and their expert control. Cheapness, at the expense of skill, in operating production and sales departments would be deemed unwise; as the credit department conserves what the other departments accomplish, surely the same disapproving attitude as to cheapness should be its right. The very highest skill for production and for selling is sought after by aspiring leaders. The management of these departments receives, as a rule, liberal compensation, and the same attitude should prevail toward the credit department. Directing the flow of goods into safe hands so that an equal value will be received, or directing loans into hands of borrowers who will repay, are tasks just as largely identified with the success of the enterprise as skilled production and selling. It is uneconomic to put a credit department in charge of untrained people merely because they can be cheaply hired; it is indisputable that the success of a business enterprise rests just as largely upon a trained and skilled personnel in its credit department as upon any other major department.

Research and Creative Work.—These features of a credit department's activities call for trained management. The department manager should continuously, diligently, and intelligently review the field of business, observe closely the country's financial trends, and never be out of touch with the economic situation of his district. The credit department should have available for the other departments a fund of information on events in the fields of business and finance. The weekly composite statement of the twelve Federal Reserve banks should be studied closely by the department's manager;

the various publications of the Department of Commerce should be received in the department and also closely studied; news items pertaining to production, employment, marketing, and finance should be gathered in the credit department as indicative of conditions that may affect credits. Correspondents should be sought throughout the territory where the enterprise operates, and from these correspondents information should be obtained at intervals on the economic conditions of their neighborhoods. There are other types of research that the credit department can develop of its own initiative; in past days, business enterprises could sail on dead reckoning and reach port safely, but today dependable charts are needed, and the credit department should be able to draft them.

There is a tendency to appraise the credit department as an uncreative function and merely a custodian of credits. The credit department is not subordinate to the other departments, of course, if its management possesses the proper appreciation of its possibilities.

Should the credit department fail to handle properly and tactfully its contacts with buyers and customers, much that the other departments have accomplished will be destroyed. The contacts established by the sales department with the buyers should of necessity be pleasant, but consider the creative powers that may be exercised by a credit department in its treatment of these customers. The sensitiveness of debtors and buyers is far keener in their contacts with the credit department than with the sales department. Should the credit department fail to be creative in its operations, there are possibilities of destroying more business than the sales department can create; but the credit department, when exercising creative powers, can establish good will and pleasant contacts in as full a measure as can be done by the sales department. Holding such an important place in the functions of an enterprise, why should the credit department ever be intrusted to unimaginative and untrained management?

Management.—As the subject of credit management will be treated later, it is only necessary, in closing this chapter, to point out that credit management, to reach the heights of creative and protective skill, must be of an executive character. Therefore, this chapter is a plea for breadth of conception, for liberality of treatment, and for common-sense appreciation of the credit department and its possibilities.

CHAPTER VI

THE PROPER APPRAISAL OF THE CREDIT DEPARTMENT

THE management of a department in a business enterprise is expected to know fully what the department's objectives are, and by what mechanism it can function as a major organ of the business. Picturing the modern business concern as a group of major departments, its efficiency and success rest on a coordination of these departments through which they will function in harmony; a business enterprise cannot attain success unless each department understands what it is intended to do and what the other departments are expected to accomplish. The production department could not of itself make the enterprise successful. The department of sales could not alone bring success to a business. The credit department would not exist were there no sales department.

Our attention is now directed to the credit department and the proper appraisal of its functions. The manager should have a clear perception of the responsibilities devolving upon the coordinate departments and he should always endeavor to keep his department free from friction. In the same fashion the coordinate managers should have a clear perception of the credit department's objectives and responsibilities, in order to avoid a great deal of lost motion. It is easier, as a rule, to comprehend the responsibilities devolving upon production, purchasing, and selling than to appreciate the responsibilities of the credit department. Instances are frequently met where executives untrained in credits have the most meager understanding of the credit function and what it contributes to ultimate success. To know the credit department thoroughly and how to operate it efficiently is expected of its manager; it should be the duty of the other department managers to know the functions of the credit department, and with this knowledge there should come concerted effort and larger returns to the enterprise.

Understanding what the credit department is set to accomplish is useful information even for the public. So many mistakes happen through unwise uses of credit that to know even a little about the functions of a credit department might prove some protection against abuses, and diminish the criticisms that result when through misuses of credit financial damage results.

The Threefold Task of the Credit Department.—A proper appraisal of the credit department reveals that its tasks are threefold. The first and primary task is to mint credit dollars of the proper weight and fineness. When a purchase is made on credit terms the credit department must weigh carefully the qualities of the risk and determine whether it would be entirely fair. Unless the decision is intelligently made the chances are that the promise of the buyer or borrower cannot or will not be redeemed. If this eventuality does occur, then a waste of all or part of the credit will result.

Should the credit department approve the delivery of the goods on the terms of sale, or the extension of a loan, then for the goods or for the money no immediate value has been received; there is no evidence of the exchange but an open book account or a written promise to pay at some future time. Just so long as the selling house has its goods or the bank has its money no hazard exists, but when the goods or the money have been converted into credit, then hazards of a greater or less degree have arisen. It is not alone the intelligence and expertness needed to make these exchanges with a minimum of waste, but the mental work involved in following the credits thus minted until they are finally extinguished that must be understood so as to appraise properly the credit department's tasks.

Guarding Credit Against Intrinsic Hazards.—When the primary task of the credit department has been finished, the goods or the loan are granted or the exchange is declined. If the manager's decision is favorable the credit department steps into its second task, to guard the credit against shrinkage. The hazards surrounding a credit are of differing degrees according to the qualities of the debtor; the credit department seldom finds a credit without some hazard. Obvious chances have to be taken and often there are hidden defects which do not appear until after the exchange has been effected.

The hazards pertaining to credits and for which the credit department must be eternally vigilant are intrinsic and extrinsic in their natures. The open book account, the promissory note, the acceptance or other bills of exchange, are mere promises, and the hazards surrounding their fulfillment must be constantly watched.

Taking up the first element of credit, character, there are hazards which, if uncontrolled, will cause deterioration. Willingness to pay an obligation is a way in which character may be expressed, and this willingness may be hurt by a change in the debtor's attitude. For the credit department no responsibility surpasses that of surrounding character with the proper atmosphere and keeping debtors in an attitude of willingness to pay. The conscience of a debtor may relapse into a condition in which he will not be troubled by matured or maturing obligations and the credit will fall below par. It is human nature to feel a stronger urge toward debt-paying from self-interest than from mere sentiment. The credit manager, therefore, should not merely preach, but should clearly manifest the substantial and lasting profits from a proper debt-paying attitude.

Defending the Capacity Element.—The hazards that occur from capacity defects or deterioration are serious. The exchange may have been approved by the credit department with a knowledge of some deficiencies in the risk, and where these deficiencies relate to the capacity element it would be suicidal for the manager not to exert his best powers to correct the defect.

The capacity needed to operate a business enterprise successfully has already been touched upon. Should goods not be properly bought, then in all likelihood they will not be profitably sold; should the debtor lack sales capacity the chances are that even were the goods well bought they will not be resold, and value received for them in time to redeem the purchase terms. If in selling the goods credits are loosely made, the chances are that the debtor's collections will not be prompt enough for him to redeem his obligations in proper time. Whenever it happens that the credit is accepted with knowledge of inherent weaknesses, the credit department manager must keep the credit under constant observation. In the large industries, wholesale and retail establishments, and banking institutions, the credits accepted run into such numbers that it is not possible for the credit department manager to keep them all under close observation, and to fix the manager's attention upon the known defects in an accepted credit there should be signals that will bring to the manager's aid the diligent attention of the accounting assistants; watching closely a large number of accounts and guarding them against preventable hazards call for considerable mental strategy. Pointing out to debtors the value of taking discounts when available is wise; the extra profit may not seem worth while to the debtor, but to stress its value and stimulate his efforts to take the discount is a protective action of the credit department. The value of displaying goods effectively is an important feature for the credit department to point out to its debtors defective in merchandising capacity. The need of discretion in selling goods to individuals on credit is a precaution against one of the hazards that the credit department should never overlook.

Risks are taken in the course of credit work where defects were not evident when the transaction was entered into; should there be undiscovered hazards pertaining to an accepted risk, then in all likelihood the debtor will show some earmarks of the defect as the account develops, and the credit department should be diligent always to discover these earmarks as they appear. Among the indications of defective capacity is slow payments. As a general rule slow payments are indicative of a serious hazard which, unless corrected, will lead eventually to failure; the causes of slow payments should be closely and fearlessly investigated. Slowness, as a usual thing, is occasioned by overbuying, unwise credits, neglect, rank incapacity, or other comparable reasons. Should overbuying be the cause of slow payments, the debtor should be checked in his buying propensities by wise and tactful counsel. If the debtor has been prone to credit promiscuously, the dangers of such a practice must be pointed out to him in vigorous fashion. Sometimes it happens that in this preventive work, the credit department may be criticized by other departments whose managers do not understand the pathology of the case. Salesmen frequently misunderstand the credit department when dealing efficaciously with the capacity hazard. But here lies the value of properly appraising the credit department's tasks.

Guarding the Capital Element.—This feature of credit management is closely identified with the protection that should surround the character element; using capital to pay the debts of a business and for nothing else should be emphasized in all contacts of the credit department with debtors. The capital hazard pertains to all types of credit and it is particularly prominent in bank credits. The moneys received from the sale of goods bought on credit or the loans received of a bank, if intended for mercantile purposes, should never be diverted into channels alien to the business. The moneys obtained from a resale of goods purchased on credit, or the proceeds of a loan, should be regarded as fiduciary funds. Temptations will arise at times for debtors to speculate with funds belonging to their creditors; the hazards of the capital element are in giving way to such temptation. The doctrine of prompt debt-paying and converting the funds of a business into no other uses is a protection to the capital element that the credit department must always stress.

Defending Credit Against Extrinsic Hazards.—This is a field in which credit management must also be alert. There will arise emergencies, accidents, and disasters which constitute extrinsic hazards to the credit risk; of these perhaps the most frequent is the fire hazard; there are hazards also in unexpected injuries to employees and to the public. Credit must be safeguarded against these as human powers permit; not to know whether the fire and casualty hazards are insured against would be inexcusable of the credit department, as these are hazards against which a large degree of protection can be secured. The debtor whose ability to meet his obligations would be impaired by an unexpected fire or accident should never be without proper insurance if the protection is obtainable. Sometimes adequate fire insurance is difficult to obtain, and in such instances the credit department should constantly remind debtors that by care and precaution the fire hazard can be minimized.

The losses occasioned by extrinsic hazards amount to millions of dollars annually. Where the proper safeguard was obtainable and not taken advantage of, the credit department blundered and the debtor was very negligent.

The most serious extrinsic hazards are of the unpreventable type. Unexpected disasters, devastations, and losses leave situations that call for the highest skill of the credit department; these unpreventable situations cannot be foreseen and their occurrence arouses the deepest distress in debtors. Only extreme patience can be exercised when credits are involved in such conditions. Pressure for the liquidation of debts will not bring results, but is apt to bring a flood of bankruptcies.

Cooperating with distressed debtors is the intelligent credit service that the circumstances demand; working with debtors to rebuild their enterprises is usually the only constructive procedure for credit departments to follow in such situations. Within recent years the ravaged coasts of Florida and the flooded valley of the Mississippi bring to mind situations where much capital was destroyed and debtors greatly distressed. Well-functioning credit departments recognized the risk imposed upon them by these disasters yet in final terms the losses were far less than if the needed patience and cooperation had not been exercised.

This second important task of the credit department is a character of work demanding expertness and patience. We can rightfully challenge the other major departments of business to reveal a situation wherein more delicate, wise, and strategic direction is required.

The Third Task of the Credit Department.—Having accepted the credit and having protected it against intrinsic and extrinsic hazards, the credit department then reaches its third task, that of closing the credit. The transaction is not finished until the debtor has redeemed his credit; this is the port of destination for the credit department always, and not until this port is reached has the credit department's voyage been finished. Sometimes these individual voyages are short and sometimes very long; seldom is it possible for the credit department to tell exactly how long any credit will be in existence—how long it will have to be watched before it is finally closed. Business will flow more evenly, disturbances will decrease, and the danger of unwise speculation lessened, when the hazards of credit are better understood and the protective tasks of the credit department properly appraised.

CHAPTER VII

QUALIFYING FOR CREDIT MANAGEMENT

The Credit Manager.—The important responsibilities and opportunities of the credit department have been presented. These can alone be realized by managerial control requiring the closest application.

The credit department is so largely confined to human factors in its contacts that a smaller amount of automatic control can be allowed than would be permissible in other departments.

The manager of credits occupies an administrative position of professional type; like all human vocations, it varies largely in skill and objectives.

Some credit departments are operated with mechanical aids to their managers, reducing the exercise of individual judgment. General plans are substituted for specific appraisals of credit risks. In the language of the "street," "credit checker" is a widely used title for this elementary type of credit administrator.

As credit management broadened, the demand increased for individual skill and discretion beyond mechanical aids—a skill required for the safe control of credits under new conditions.

Left to incapable direction, credit would court disaster; though dimmed by the glare of production adventures, yet the need constantly increases for credit executives of clear vision, courageous prudence, and trained leadership. Like other professions, credit management is not an endowment; it is the reward of persistent striving for the qualities necessary to success.

Executive skill portrays the progressive attainments of the credit manager; a gradual expansion by persistent application of his powers to determine the wisdom of credit exchanges, and to make every feature of credit administration successful. To reach this objective certain qualities must be cultivated and practiced; these qualities have not been standardized. Before proceeding with a discussion of the qualities usually considered important we shall consider a test that may postulate success or failure.

Adaptation.—The business system is composed of many members performing different functions, of which that of creating and retiring credit needs the control of those especially adapted; it needs charts and direction that the uncongenial mind cannot supply. Good credit management demands an analysis of details, and sometimes important discoveries reward the diligent follower of small clues.

Credit management requires the translation of figures into accurate pictures of a debtor or a business; it seeks the revelation of human nature and its pursuit often reveals the secrets of character and capacity. There must be persistent application to acquire and develop the qualities needed for success.

Thoroughness.—This is a foundation quality for good credit management. Many losses occur because investigations have not been carried far enough; every item of information about a credit should be secured and carefully weighed before a decision is reached. The public would feel aggrieved should a judicial decision be handed down upon incomplete evidence. The decision of a credit manager does not rank in public estimation with a judicial decision, but should the former be based upon imperfect evidence, an unethical act has occurred, and should damage result the public will bear the costs. Reaching decisions offhand, indulging hunches, and yielding to pressure for action before investigations are completed, are practices potential of bad consequences; thoroughness alone can be cultivated by adherence to the resolution that no case will be decided until all the facts bearing upon it have been assembled and judiciously appraised; that credit accounts will be observed closely and no feature of the manager's responsibility neglected. The acquisition of thoroughness demands constant effort.

Temperament.—The credit manager holds a unique position; not only must information and evidence be gathered thoroughly and no available important item passed by, but these items must be interpreted. To appraise properly the character, capacity, and capital elements of a credit, the manager must judicially determine whether the assembled information would justify the exchange; seldom will the information gathered clearly indicate the complete safety of the risk. In most instances the evidence will not perfectly balance and the manager must decide whether the favorable or unfavorable side preponderates. The acquisition of this judicial temperament results from the desire to decide wisely and from weighing the information in each case with the utmost care.

Balance.—The credit manager contends with more cross currents than will usually confront other department heads. The sales department is interested in the outcome of a credit investigation; the major officials of the organization are frequently inclined to regard sales volume as the chief medium for profit-making, and will therefore view critically the credit manager's unfavorable decisions.

A large amount of human spine is needed at times to resist these influences. As in the public courts decisions are sometimes reached in opposition to public sentiment, likewise in the credit tribunal decisions are reached uncongenial with the ideas of coordinate departments. There is no department of business administration where untrained judgment and prejudices can occasion more unfairness than where the human capacity for credit is measured. Stern stuff is demanded of a credit manager when his decisions are unpopular. But he receives his eventual reward when the wisdom of his decisions is proved by the later histories of rejected applicants. Irrespective of how popular or unpopular the final judgment may prove to be, the manager must not swerve from an even balance in weighing carefully and deciding the eventual possibilities of the risk. This attitude must be free from offensiveness, and to this end the facts upon which a decision is based may be disclosed in confidence to interested departments.

The cross currents running athwart the credit department create situations that frequently subject the moral powers of the manager to critical tests, and nothing will so badly shatter his influence and standing as easy and frequent changes of decisions.

When gathering the available facts and information on a credit, when considering thoroughly the information, and when reaching a decision, it is important that the decision should not be changed except upon the offering of new facts, unobtainable when the case was originally considered. The quality of flexible firmness is necessary to the credit manager, for should it be surmised that his decisions can be influenced by importunities or by pressure from high places, there will undoubtedly result a derogation of his position. This quality must not be confused with obstinacy; it is a characteristic in which reason controls, and that will yield to appropriate and convincing evidence. There are frequent occasions when the manager's decisions will be complained of by salesmen and by the applicants for goods on credit and for loans. Pressure may be exerted for reversals of the manager's position, but this should be resisted and reversals of decision denied unless new and favorable evidence can be submitted.

Flexible firmness will be a difficult quality to practice at first. Pressure can be brought to bear upon the manager that may be beyond the powers of a novice to withstand; to cultivate the quality, each instance of courteous and firm adherence to a decision reached will improve the practice and lead to its eventual attainment.

Imagination.—Imagination will bring under review the circumstances of a credit risk that are not obtainable through the customary channels, and will contribute in large measure to the reaching of wise decisions. It is not possible to reach thorough control without an active imagination, the acquisition of which comes in part from the desire to possess it; exercise is its nourishment.

Cooperation.—This quality may be called the atmosphere of credit management; it is the quality that leads the credit manager to realize the interdependence of well-organized departments. He must seek to understand sales problems and the difficulties of successful merchandising; how a prospective customer is interested and the technic employed to promote his interest. The credit manager of a bank has no sales department in his organization with which to cooperate; yet the bank is constantly performing sales work of some type and therefore he should always be in full accord and cooperation with the coordinate departments.

It is not possible for a credit manager to be broad and constructive in carrying out his responsibilities unless he comprehends sales problems, merchandising problems, and especially what makes or breaks a merchant, and the cooperative quality will keep the credit manager eternally vigilant. Signs of defects and distress in a credit will appeal directly to this quality, and its alertness will lead the credit manager to serve and to save.

The quality develops from a close observation of the merchandising or the financial fields, and from a desire to understand the problems and the technic of other departments, and to work with them for the success of the enterprise. In the cultivation of this quality the credit manager has no better means than the inspection of sales and merchandising problems at first hand. Frequent visits should be made with other departments and with the customers; meeting customers, gleaning from them the nature of their problems will provide an academic training for the manager in the problems and conditions with which credit must contend. It frequently happens that he will thus uncover situations that financial statements and other forms of credit information have failed to disclose. The vitalizing of a business organization can be helped or hindered by the degree to which the credit manager succeeds in developing a "sales sense" and in having his associates understand his own department.

Tactfulness.—The delicacy of credit work demands tactfulness in management; blunders may occur in other major departments without causing permanent damage, but blunders of the credit department are seldom overlooked. Instances are frequent where the information needed for a just decision can be obtained from the applicant alone. Nothing is more apt to prove irritating to the average individual than to be interrogated about what he has and what he owes, and while the progress made in the knowledge of credit practices has eased the difficulties of securing information direct from individuals about their financial and credit affairs, yet there is likely to be some irritation from these queries unless they are made with the utmost tactfulness.

Rudeness and high pressure devoid of tact are fraught with the highest dangers to credit work; the history of credit management is spotted with the damage occasioned by the absence of this quality, and it is unfortunate because the damage was preventable. It can be contended for the credit manager that his functions are of a nature that subjects his disposition to a severe test. He may be apologized for at times when a rasping disposition gets the upper hand, but it is a dangerous temperament to indulge, and if unrestrained will cloud his judgment.

Honesty.—Other qualities than those we have considered play some part in credit administration, but the capstone of them all is honesty. This does not imply alone an abstention from vicious practices; its wider significance is the exercise of good faith and fairness. It demands truthfulness in carrying on the credit task, and clearly realizes the naturalness of reciprocal treatment—that the credit manager may not expect people to be honest with him when his own good faith is lacking. The credit manager whose word need never be doubted and whose fairness is never questioned possesses an attribute of the highest importance to success.

Training.—The executive work involved in efficient credit management could not be carried on without good and diligent training. There are tools that the manager uses in his work, and damage will result if these are not used intelligently. He must possess a thorough knowledge of the department's mechanics, the elements out of which credit is made, the assembling and interpretation of information, and other functions of the department that cannot be gathered offhand, nor apprehended other than by training and experience.

The credit profession is not old enough to have evolved standardized methods of training, but there are various means available to the student desiring proficiency. Colleges of business administration now offer courses in credits; the National Institute of Credit, organized as a department by the National Association of Credit Men, is devoted to credit training which will qualify for credit management, and in many of our principal cities evening classes in credits are featured by commercial schools. The advancement of credit uses and the increase of its problems have tended to popularize academic work as a training field for the credit desk.

Apprenticeship in a credit department is a practical way to acquire training for the manager's task. There is nothing superior in the training process to a first-hand inspection of the credit department mechanics. Good tutoring in a credit department, assisted by a carefully laid out program of scholastic study, will for the adaptable student result in the laying of a good foundation upon which experience can build.

One dominating fact must be recognized in the training process—the absence of "graduation day"; the training for credit administration is never finished. The occupant of a minor position will have much ahead of him to accomplish and the matured credit manager will meet constantly new problems and new conditions that will demand further training to master. The day never arrives when the credit manager can truthfully say, "There are no further worlds to conquer."

CHAPTER VIII

THE CREDIT SENSE

A New Conception in Credit Management.—The modern challenge of credit and the recent unfolding of a practical technic for credit management have kept textbooks on the subject close to fundamentals. But it is now possible to widen the horizon and climb heights not usually scaled in this profession, and there is no blazed trail to point the way.

The particular quality entitled "credit sense" almost defies definition. When highly developed, credit sense operates instinctively, but it must not be confused with instinct. Sense is intelligence, while instinct is "an unreasoning prompting to any action." Credit sense is an intelligence so trained that signs of safety or unsafety in a credit risk will be quickly and accurately judged.

Credit sense has been described as good judgment-made habit; it is a quality acquired by wise, patient, and persevering analyses of credit elements, combinations, and situations. It is the reward of untiring and intelligently directed efforts to master the best skill in credit administration.

When confronted with his task of minting credit dollars, the manager will ponder seriously to determine whether the credit offered for the goods or money would prove to be a fair exchange. Following a credit to its conclusion will also test the manager's spirit and his adaptation to the credit task. Thoroughly analyzing each transaction and making notes of the combinations and characteristics that develop satisfactorily or prove disappointing will gradually construct a facility of judgment that operates with precision. These cumulative judgments are the foundation and the material from which credit sense is built. The earmarks of defective elements in a credit or signs of distress in an accepted risk may be undetected by the novice, but to the credit sense they are perfectly clear and rightfully judged.

How the Credit Sense Functions.—The well-developed credit sense will never neglect minute things in its judgment of credit risks; it frequently occurs that the most serious situations in a credit manager's experience are unearthed by following persistently the smallest clues. Everything that appears like a defect must be observed and rapidly judged in its bearings upon the debtor's welfare; it is in these delicate situations that the credit sense exercises its discernment.

If a defect originates in the credit before its liquidation, some sign of it will almost invariably appear; the credit sense is usually quick to perceive these earmarks and signs of inner distress, and it will proceed directly to a discovery of the causes. Situations are frequent where, in assembling ledger transactions to determine the acceptability of a credit, the reports are not uniform. The houses to whom the buyer refers report satisfactory experiences and payments largely on a discount basis; the ledger experiences assembled by a credit interchange bureau reveal in a number of instances unsatisfactory dealings and slow payments. The credit sense will not be satisfied with noting this discrepancy, but will seek its causes. Were the discounted accounts put intentionally on this basis for window-dressing purposes, or were other circumstances in the buyer's financial condition or management methods responsible for these variances? In this not uncommon incident the lack of uniformity in payments is a sign of something beneath the surface. The credit sense in credit management would not form a judgment on surface appearances, but would balance the various factors against one another, study the analyses of similar situations, and wisely decide on the action to take. It may have happened that the buyer was guilty of ulterior motives, or merely needed a little prodding on the credit value of uniformly prompt payments.

Experiences often occur where a well-thought-of account suddenly changes and payments lag. The change had taken place without warning to the credit department, and no situation can challenge more the manager's deftness and skill. It is a sign of some inward trouble that may be neglected in view of the debtor's previous record, but credit sense should never be satisfied to fall asleep in such a situation. On the contrary, the manager under the impulse of this motivating sense should be aroused to action and ceaselessly endeavor to ascertain the causes, and if trouble has really developed use his best powers to heal it.

The credit sense is tireless, and will not permit the manager possessing it to be listless where there are earmarks, signs, and portents to translate.

Credit sense operates from the axis to the periphery of credit exchanges; not a segment of commerce conducted on credit terms is free from its comprehensive discernment. The financial credit manager, directing large loans or passing judgment upon large investments, needs a refinement of the sense quality adapted to his particular work. No characteristic, sign, or earmark in a borrower, irrespective of its surface insignificance, should escape this credit sentinel. Unfavorable changes in liquidating velocity ratios will naturally arouse attention and inquiry. But signs of personal extravagance, neglect of business, and immoral habits, leading, if uncorrected, to failure, can easily slip by the unwary manager. The bank failures that have taken place during the past decade constitute a page in our financial history of which we can be heartily ashamed. A large proportion of these failures were the result of inefficient credit management; loans were made without discernment of the qualities needed for safety, or the credit sense was lacking to interpret signs of weakness in collateral or foresee the changes that might affect the abilities of borrowers to pay.

Passing to retail credits, there is found a place for the credit sense adapted to this particular field. Material evidence of the buyer's worthiness is more limited in retail merchandising, and to the credit manager there are offered splendid opportunities to exercise the credit sense. The individual when approaching the credit manager should be closely studied for signs of undependability. The slightest evidence should not be permitted to pass unchallenged. It frequently happens that a minute surface sign is related to a serious internal disorder. From the first interview to the closing of an account the credit sense will be constantly watching for indications of weakness or strength, pointing out where business should be cultivated or transactions should be carefully guarded.

Actual Occurrences.—Credit managers of wide experience can extract from their administrative work numerous episodes of credit sense activity, such as those that follow.

In 1914 the business and financial communities were shocked by the failure of an old and highly respected wholesale house which was identified financially with a number of retail outlets. The paper issued by this house ran into large figures and was liberally bought by leading metropolitan banks. As the close of its career was near some of its paper was offered by a note brokerage house to a small bank in a Mid-Western city. With the paper there was submitted, a copy of the house's latest financial statement, on which appeared no contingent liability; but in the bank's portfolio was a note of one of the retail outlets bearing the indorsement of the wholesale concern. As many important banking institutions were buying this paper freely, the discrepancy could easily have been glossed over, but the sign was evident and judged as suspicious of weakness. The credit officer refused to buy the paper, and had he not done so his bank would have been a creditor when the failure occurred.

Another illustration is taken from a narrower field, but it is no less descriptive. A credit manager whose mental processes were keenly alert was visiting some customers. He was talking with a small country storekeeper who had not been satisfactory in his payments, and during the talk the storekeeper's wife came in and took some goods from the stock without offering any explanation. The credit manager asked an explanation of the storekeeper, who said that the goods were needed for the home and it was customary for his wife to take from stock the goods she needed. "Do you make no memoranda of these goods?" queried the credit manager. "Why, no!" replied the merchant. "The goods are needed for the home and that is all there is to it." The closing of that account was decided upon immediately by the credit manager, and rightly so, for in a little while this inefficient merchandiser was among the business unfortunates.

The credit sense is illustrated also in the following incident:

A voluntary order of large proportions and well-assorted styles was received by a Mid-Western wholesale house; the buyer, ostensibly a merchant located in a near-by city, who had never previously favored the house with business. When the order was referred to the credit department, the manager noted that the merchant was highly rated. As it was not good credit form to approve the order on rating alone, the manager asked a report on the merchant from a mercantile agency. When the report was received the manager found that the street number appearing on the order was not the address given by the agency; there were no discrepancies in the merchant's name and street name.

The difference alone in street numbers appeared trivial. It seemed reasonable to assume that the highly rated merchant had favored the house with the order, and the credit manager was strongly urged to approve it, but, not satisfied to act on a presumption when the origin of the order could be verified, the credit manager mailed an acknowledgment card to the merchant at the address given by the agency, and assured prompt execution. The merchant wrote immediately that some mistake had happened. "I gave you no order," he said, "and I know nothing about it." The scheme of a fraudulent operator to victimize the house was bared by the credit manager's credit sense. Had the order been executed and the goods shipped, they would have been delivered at the address furnished on the order and immediately disposed of at any price. This credit confidence game cost many thousands of dollars until it became trite and unworkable. Its checkmate was credit sense.

The Credit Sense not Solely Negative.—Credit is a combination of elements that seldom run evenly; favorable factors may outweigh the unfavorable indications, or the contrary. Balancing the elements against one another and judging as to the future are the credit manager's prominent tasks, and in their performance the smallest bits of evidence are readily seized and weighed by the developed credit sense. In deciding on the exchange and then protecting the credit against hazards, watchfulness is called for of unfavorable symptoms, but the constructive procedure is of equal importance. A credit, when examined, may show points of strength in all the important elements but capital. In such a combination surface appearances should not dominate, and the farseeing credit manager realizes the possibilities of capital building by cultivating capacity in a careful manner. Overindulgence is avoided; the credit transactions are harmonized with the buyer's ability; and as the one expands so will the other.

In a credit signs of trouble may appear, which when analyzed may be found to result from the debtor's inability to meet competition. In such a situation credit sense is apt to direct the credit manager not to relegate the debtor to the list of undesirables, if he be amenable to merchandising advice and if there are possibilities of building him into a successful merchant. Credit management, when in command of the proper sense quality, is distinctively constructive. Favorable and unfavorable indicia are intelligently judged, and possibilities are followed through, thus constructing a sound credit structure on what first appeared as an unpromising foundation.

The Credit Sense and Ethical Standards.—No aspect of business is more thoroughly dependent on ethical standards than credit. The promise to pay rests for its intrinsic value on moral elements largely, and the ability to determine the value of the promise rests upon ethical attitudes in management. Credit sense convincingly reveals to the credit manager that he cannot receive without honestly reciprocating; that he cannot lie without being lied to; that his practices are as "the bread spread upon the waters" that will return to him of no better quality than he sends adrift.

Disappointment may chill the credit manager when a competitor inquires about a prized account. Four decades ago the credit department would not balk a moment over giving doubtful information, but now intelligent sense dictates an accurate reply, for to do otherwise would violate the entire decalogue of credit cooperation. A debtor may become distressed and the serious nature of the trouble discerned by one credit manager before the situation is revealed to the others interested. The debtor's assets in liquidation would not pay everyone in full, but it might happen that he who discovered the situation first would be able to obtain his money and throw the onus of liquidation on the remaining creditors. The proper attitude to take in such a situation is held by some to be debatable. But retaliation is inevitable; the credit manager who acts upon the sign for his advantage alone will at some time be compelled to change positions and swallow the bitter dregs of loss. Credit sense points to the value of using information for the benefit of all concerned when the assets cannot be stretched far enough by liquidation to pay everyone in full.

Something more than natural impulse is needed to discover the profit in a sincerely ethical attitude in credit relations, and the developed credit sense never swerves from control when the credit manager is torn between two contentions. When at the crossroads, the sense quality will prevent the credit manager from following the broad highway and point to the eventual satisfaction of pursuing the rugged path.

Contemplating all that we have learned about this useful quality, is there not some justification in declaring that the credit sense is in reality the credit manager's personality?

CHAPTER IX

CREDIT ECONOMICS

BEFORE discussing the tools available to the Credit Manager for ascertaining the acceptability of a credit, certain economic facts relating to credit will be considered.

Credit, Our Present Currency.—The twentieth century marked the beginning of a new era in our financial practices. And after its turn, the resources and deposits of our national and state banking institutions grew rapidly. The prejudices and fears of big banking, that so heavily colored earlier financial history, gave way to a common-sense appreciation of the bank's position and its constructive powers. This financial awakening brought a new form of currency, the bank deposit, into popular use. The check, as a medium for transferring deposits, became a money token and largely superseded the use of legal money in trading transactions.

Credit currency, by possessing flexible and clearance elements, has fostered and made possible our financial expansion. On a money economy alone the financial progress we have attained could not have been possible.

To illustrate: The twelve Federal Reserve banks reported in 1929 a circulation of checks that amounted to more than 800 billion dollars, charged to individual deposit accounts. On June 30, 1929, the national and state banking institutions reported to the Comptroller of the Currency time and demand deposits approximating 53 billions. These statistics revealed a velocity in deposit circulation of nearly sixteen times in 1929. From these figures we can confidently deduce that the permanent nature of money would not have permitted a velocity of turnover equal to the circulation accomplished with ease by the credit currency. The checks charged to individual deposits in 1929 were more than double our entire national wealth.

The power displayed by credit to sustain a commerce of such enormous proportions constitutes one of its most useful qualities.

Gold, the Base of Credit.—The dynamic element of credit is its conversion into real value at some fixed time. The ending of each credit transaction must be as definite as its beginning. The temporary existence of a credit is the characteristic that makes it so usable for large exchanges.

It has been deemed wise, in financial jurisprudence, to establish by law the extent of money reserves that banking institutions must have available at all times against their deposit and note liabilities. Experience has proved that, in fixing safety limits for bank reserves, that central institutions, such as our Federal Reserve banks, must carry a larger reserve than is thought necessary for the smaller institutions. The reserves of our banks are graduated, agreeable to this formula.

In non-banking fields credit judgment is the determinant of safe reserves. This judgment will frequently go amiss when sales pressure or speculative fevers contaminate the business atmosphere. As a rule, however, the credit judgment can measure the limits of reserves needed for the safe support of credit in a surer way than is possible by political determination.

We have shown that gold is our only real money; that our money tokens may be converted into gold by statutory provision. It follows by deduction that reserves against the liquidation of credit balances must be figured in terms of gold. This is the practice in all of the countries operating on a gold standard. Bank credit is based on gold.

When the Act of 1900 placed our monetary system on a gold-standard basis, we possessed in monetary gold a little more than 1 billion dollars. The year 1900 marked our passage into a wonderful financial period. That year the checks passing through our clearing houses approximated 84½ billion dollars. The deposits held by all of our banks in 1900 were about 7¼ billions. Passing on to 1929, our monetary stock of gold that year had risen to 4¼ billion dollars; the checks reported as having passed through our clearing houses approximated a total of 726 billions. The deposits held by all of our banks in 1929, as already stated, were 53 billions.

Experience has proved that a unit of gold will safely support ten units of credit. When the credit machinery is in good control and the business atmosphere is not impregnated with unsound theories, the credit superstructure can be raised without fear. Under proper conditions a unit of gold can sustain thirty units of bank credit.

The useful manner in which such credit can function and the aid it can give in realizing financial opportunities, has been vividly demonstrated since the opening of the World War in 1914.

The need of credit for the largest transactions ever underwritten by governments in all world history led to the removal of gold from circulation. Its chief service now in public finance is to furnish a reserve base for credit currency. It is rare for us to carry a gold coin for pocket purposes. Not more than one-tenth of our monetary stock of gold is in circulation. The same impounding process for reserve purposes has been going on in all of the leading nations since public indebtedness has so greatly increased. The single standard upon which most of the leading nations now operate has led to a tremendous scramble for gold in recent years. The needs for gold in monetary systems and for the fine arts exceed its production.

The basing of credit on gold as a reserve for the liquidation of final balances is one of the mystic movements in credit finance, and to the unobserving is not readily detected.

The evolution of our Federal Reserve System since the inception of its operation in 1914 further illustrates the relation of gold to credit.

On December 30, 1915, the twelve Federal Reserve banks held in reserve 345 millions of monetary gold. Supplying the Allied Nations with munitions and foodstuffs for war requirements, in unprecedented quantities, created balances that called for large sums of gold to liquidate. There resulted heavy imports of gold, and when we entered the World War the twelve Federal Reserve banks held a gold reserve of at least one billion dollars. This centralized gold reserve continued to mount, and at the close of the war was assessed at more than two billion dollars.

The credit transactions conducted by our government in the form of borrowings from the people would not have been possible had we not possessed this large stock of reserve gold. The nation's borrowings for its own needs and for the assistance of its allies increased the public debt twenty-five times. This constituted an act of public financing that would have been deemed impossible five years before.

Upon our entrance into the World War the twelve Federal Reserve banks had earning assets of approximately 200 millions. At the close of the conflict the Federal Reserve earning assets had risen to more than 2 billions. The liabilities of the Federal Reserve banks at the earlier period were 1,200 million dollars, and at the later period they had grown to 5 billions.

Credit had displayed its adaptation to large financial transactions in a splendid manner. No other medium of exchange could have performed the service in this historic period that was accomplished by credit without a serious strain.

As a currency device for the transfer of values, credit cannot be used properly unless its dependence upon a reserve for the liquidation of final balances is respected.

The evolution of credit into currency uses has in reality made money unnecessary except for the payment of balances and for pocket purposes. The intimate relation of credit to gold as a reserve leads next to a discussion of inflation in credit economics.

Credit and Inflation.—The term inflation, as related to credit, pictures a superstructure of credit taller than the reserve foundation can safely support.

The financial disturbances and panics, dotting with frequency the pages of our economic history, result always from the inflation of credit. When good control is lacking, credit may be used improvidently during periods of bad financial psychology. Feverish speculation can force credit out of its proper boundaries and lead eventually to situations where the reserve is not strong enough to sustain the superstructure.

These hazardous situations too frequently escape financial observers until some disaster takes place. When the inflated structure is about to crumble, the public involved becomes disorderly, and unprofitable liquidations are precipitated. Serious losses are sustained when a careful look around for the "exit" might have saved a débâcle.

In a final analysis, the financial panic is no more than a disorderly liquidation. The motivating cause of a financial panic is the thinning of credit, in ratio to its reserve base, to so large a degree that the superstructure cannot be held steadily in place.

The business enterprise, as the pivotal feature of our credit circulation, represents, upon analysis, the conversion of capital into merchandise, equipment, and other accessories of a trading institution. The merchandise is converted into receivables, and in turn the receivables are reconverted into money. The formula for success in this circle of merchandising is, gaining a velocity in these conversions that will assure the integrity of the original investment and some increase from year to year.

In the conduct of a business, and with credit playing such an important part, good judgment must be exercised in the contraction of debts. The credit used for the purchase of merchandise and equipment should not at any time be disproportionate to the liquidating value of the business assets. When this disproportion does occur and the ratio of assets to liabilities becomes of too narrow spread, then the liquidating capacity of the enterprise is in peril. A condition of this description pictures credit inflation.

We now turn to a larger field for a dramatic illustration of credit inflation. The immediate post-war years were contaminated by financial theories that violated the rules of good credit judgment. These unwise theories gripped the business judgment so completely that commodities were produced in larger quantities than could be consumed by the public. A large portion of this production was financed by credit. Goods were ordered in the confident belief that they could be turned over rapidly and at large profits. As usually occurs in such situations, prices rose rapidly in this speculative orgy. The financing of this speculation in commodities strained the loaning powers of our banks. They were drafted upon to an unwarranted extent and the Federal Reserve banks had to meet abnormal credit demands from their members.

The intensity and extent of this speculative movement wore down considerably the bank reserves, and the credit spread became dangerously thin. Toward the close of this thoughtless period the Federal Reserve banks had nearly reached the limit of reserves allowed by law. We designate this episode as an instance of credit astigmatism. The inflationary movement continued until a peak was reached beyond which it could not go.

The flimsy structure buckled and would have crashed, with an attendant damage unparalleled in our commercial history, had not the Federal Reserve System met its first great liquidation test. Placing its banking powers under the weak credit structure, deflation became orderly and business was saved the paroxysms of a panic. However, the deflation was costly, and the production profits of several years were wiped entirely out and our industrial energies atrophied.

Similar in its characteristics, differing only in the turn speculation took, was the distressing episode of 1929 in the securities markets. This also was a drama of credit inflation.

Securities were created and thrown upon the market without intelligent measurement of the public's abilities to absorb them. The securities markets intensified their speculative tendencies by progressive degrees; and eventually the people were again in the bonds of a bad financial dream. Securities were bought widely and eagerly on credit—not for investment purposes, but in the expectation of rapid and profitable resales. As prices advanced in this speculative trading, more credit was needed to finance the same securities as they were transferred from buyer to buyer.

The Federal Reserve administrators were alert to this hazardous situation. They recognized that building a structure of credit on security commitments without a proportionate increase of the underlying reserves was fraught with great danger. To stem the rising tide of inflation, the Federal Reserve banks raised their rediscount rates, and member banks were urged strongly to restrain the flow of bank credit into the securities markets.

The public ignored all danger signals. The stock exchanges witnessed a daily turnover of securities with increasing velocity and volume. Larger amounts of credit were needed to finance these transactions. The demand for credit exceeded its supply for security trading and call money rates advanced. The high rates for money attracted a large flow of credit funds into the stock exchanges from non-banking sources. The process continued until October, when loans to brokers had reached a record volume; the situation was laying a heavy burden on commercial borrowers.

Finally, the stage was set for another financial disaster. Unfavorable symptoms appeared, and almost like a "bolt from the blue" the pyramid of credit toppled and prices tumbled in a disorderly manner.

The damage in this credit episode might have been serious had not the Federal Reserve banks for the second time met a severe liquidation test. The resources of the Federal Reserve banks buttressed the deflating structure and only the unthinking speculators had burned fingers to nurse.

These episodes of credit inflation are magnified instances of what goes on daily in more restricted fields. The ease with which credit may be inflated by building too large a superstructure on a reserve foundation, brings out in vivid color the importance of intelligent credit control.

Upon the credit manager rests the control of the flow of credit; in no instance must its liquidation be imperiled by an insufficient reserve. This responsibility appertains to all types of credit management and can no more be evaded in the control of individual credits than in the making of large loans.

The credit manager of a retail establishment should estimate a customer's capacity to liquidate the smallest purchase. If it happens that the individual debtor, after using the goods bought on credit, hasn't a reserve sufficient to liquidate the debt, then the credit, even though it amounts to a few dollars only, is inflated.

In wholesale merchandising, the credit manager is under the constant test of liquidation hazards. In illustration: A debtor may have merchandise and receivables in the sum of $10,000. His indebtedness for merchandise and borrowed money amounts to $5,000. His financial condition shows a ratio of current assets to current liabilities of two for one. Credit judgment regards such a ratio, if the merchandise and receivables are not subject to excessive depreciation, as reasonably safe.

The same debtor, after operating for several years, shows in his financial statement merchandise, receivables, and cash of $20,000. He owes for merchandise and borrowed money $12,000. The merchant's operating capital has increased $3,000, but, to the contrary, his credit obligations have increased $7,000. The liquidating safety of this business has declined one-fifth, and from a reasonable risk it has receded into a hazard.

The financial credit manager must be constantly vigilant in directing the flow of bank funds. The proper ratio of indebtedness to reserve cannot be overlooked in the faithful performance of his managerial duties. The line dividing reasonable safety from hazards in credit transactions is not always easy to discern. When the line is passed, however, inflation has its beginning, and if uncontrolled, postulates disaster. The constructive possibilities of credit management may be displayed and a real service performed by assisting reserves to grow proportionately to the credit that may be profitably used.

The economics of credit will appear in new situations and problems as our knowledge of its real nature expands and new fields appear for its uses.

CHAPTER X

THE CREDIT MANAGER'S TOOLS—THE FINANCIAL STATEMENT

The Measuring-rods of Credit.—It is the credit manager's primary task to measure the dimensions of a credit and to determine if it is wise to open the account. As credit's major qualities are solely human, the devices for measuring them will never function perfectly, which is the reason that risk is inseparable from credit. The hazards of accidents, emergencies, and changes call for the exercise of diligence and skill in using the tools available to credit managers for opening and safeguarding accounts; at the best, a diligent manager will be rewarded with proximate and not absolute certainty in measuring the dimensions of a credit.

Experience has shown that the credit dollars constantly coined and circulated in our trading and financial operations are never entirely retired. Some depreciation will occur because of changes or conditions taking place after the credits are created. The tools for measuring credits are intended to maintain a circulation commensurate with legitimate, private, and public needs, but a circulation that can be retired at a minimum of depreciation.

The Operating and Financial Statements.—In explanation of the services performed by these measuring-rods, the operating statement is designed to reveal the velocity of capital uses and the extent of profit accumulations. The financial statement reveals the abilities of an enterprise to provide for its payables in all reasonable situations. The financial statement discloses also the margin of safety of invested capital against liquidation hazards.

Business concerns of large proportions publish separate and periodic operating statements and copies of their balance sheets.

Moderate-sized concerns usually furnish operating and financial figures in a consolidated form; this combined form is designated, generally, as a "property statement."

Below is an illustration of the operating statement and balance sheet as they are customarily prepared.

Income account (operating statement) of the Home Skill Trading Co. for the year ended December 31, 1929:

Total income from sales	$2,400,000	
Profit from sales		$360,000
Operating expenses		240,000
Operating profits		120,000
Dividends paid		60,000
Net income		$ 60,000

Balance sheet of the Home Skill Trading Co. as of December 31, 1929.

Assets:		
Merchandise	$900,000	
Cash on hand and in bank	50,000	
Accounts and notes not due	250,000	
Accounts and notes past due	50,000	
Current assets	1,250,000	
Furniture and equipment	135,000	
Warehouse and land	250,000	
Total assets		$1,635,000
Liabilities:		
Accounts payable	$295,000	
Loans from banks	125,000	
Current liabilities	420,000	
Reserves	10,000	
Owing on equipment	10,000	
Mortgage on real estate	50,000	
Capital stock	1,000,000	
Surplus	145,000	
Total liabilities		$1,635,000

When the operating and financial figures are combined in one statement the form will provide for the following statistics:

Annual sales for cash.
Annual sales on credit.
Total annual expenses.

Uses of the Statements.—The investment of capital in a business is never free of hazards, and these hazards deserve the reward of reasonable profits. The operating statement and the balance sheet are tools for measuring the profit-making powers of a business and for discovering any danger that threatens. When the figures are accurate they are excellent measuring-rods of capacity and capital; frequently the figures and ratios of these statements will reveal the character element of a credit.

The operating figures are the measurement of profit-making; the safety of payables and the integrity of capital are determined by the balance sheet. The operating statement furnishes the velocity ratios; the balance sheet furnishes the static or liquidation ratios; these ratios measure business success and safety.

Profits and Depreciation.—The ability of a business to assure the safety of its payables and to protect its capital against liquidation hazards is measured by its profits. The portion of capital invested in merchandise or materials constitutes the major profit-earning asset.

The difference between total income from sales and the cost of merchandise or materials must be sufficient to provide for operating expenses, interest charges, reasonable compensation to owners, and something besides for capital safety; a proper margin of profit per unit in price calculation must not alone be provided, but an accumulation of profits realized from a volume of sales commensurate with credit safety. To assure the needed profit accumulation the earning assets must have a proper velocity of turnover.

Profits are subjected to a serious danger—depreciation. In the operations of a business a reasonable profit may be realized and yet prove insufficient to overcome the depreciation of assets, which invariably occurs and which is one of the hazards with which management must contend. Merchandise and materials are depreciated by the accumulation of unsaleable ends, style changes, unwise buying, and other causes; receivables depreciate through uncollectible accounts, insolvencies, and various types of claims; real estate is not constant in value and depreciation may attack this fixed asset beyond reasonable foresight to prevent; fixtures, plant and equipment depreciate rapidly, as a rule, and obsolescence must always be allowed for when these capital items are appraised.

The depreciation that occurs in earning and fixed assets must be absorbed by profits, and will be reflected in the balance sheet after the current and fixed assets have had a proper evaluation. Certain situations arise at times when falling prices or other serious emergency will necessitate severe depreciations, which may be serious enough to destroy entirely the accumulation of profits and even to threaten the capital investment.

From every observation post it is clear that credit safety rests upon profit and depreciation control. More than two million business enterprises are operating today in our country, a host of which are small, have no dependable accountancy records, and are sailing the highseas of finance without proper charts; they will account for a major portion of our commercial failures. In determining the credit dimensions of these concerns surmises alone can be made because accurate figures are not available; surmises are poor substitutes for intelligent deductions founded on exact statistics.

The Velocity and Liquidation Ratios.—Applying the velocity test serves the dual purpose of measuring potential profits and depreciation. To illustrate the revelations of these ratios the operating statement and balance sheet of the Home Skill Trading Company will be adopted. The capital invested in merchandise is subjected first to the velocity test. To make merchandise profitable this earning asset must enjoy a turnover consistent with sales terms and liquidation safety, and we shall assume that the Home Skill Trading Company sells its merchandise on terms of sixty days net from date of invoice and 2 per cent discount for cash in ten days.

The company shows in its operating statement a volume of sales for the year of $2,400,000, and in its balance sheet a merchandise item of $900,000. When the terms of sale are sixty days, 2 per cent in ten days, the velocity of merchandise turnover should be at least three times a year.

Reducing potential depreciation to a reasonable minimum for this earning asset, the cost of merchandise should not be more than 30 per cent of the annual sales. In this instance the merchandise exceeds 30 per cent of the sales income and is nearly 45 per cent of the net cost of the goods sold. The ratios clearly manifest that the company is carrying too large a stock of merchandise. The depreciation risk is increased proportionately and prudence suggests a reduction of the merchandise by at least one-fifth, but with no change in the sales volume.

The receivables are next placed under the velocity test. The sales terms, and a careful selection of the credits, should produce a volume of receivables not exceeding forty-five days' business at any time. On the statements the balance sheet shows receivables, due and past due, equal to forty-five days' business. Of this total one-sixth is past due. The ratio test reveals a good velocity of collections, but the past-due receivables are subject to depreciation dangers; credit experience has shown that a large portion of our insolvencies are due to slow collections.

The entire capital must also be subjected to the velocity ratio test. Captial must not move sluggishly; it must have action, or depreciation is likely to take place that will exceed a reasonable estimate. As a proper test the net worth, or capital, of a business should enjoy a turnover of at least twice a year. The Home Skill Trading Company shows on its balance sheet a net worth of $1,145,000, which is less than one-half of the annual sales; the velocity test reveals that the net worth is having a turnover of more than twice a year and it is satisfactory by a good margin.

The final major velocity test is the ratio of fixed assets to annual sales. Fixed assets are important to the successful operations of a business, but it is not the usual practice to designate them as earning assets; they are subject to severe depreciation under certain conditions, particularly should the business have to be liquidated. The fixed assets are considered of safe and profitable proportions when they do not exceed one-third of the annual sales. The fixed assets of the Home Skill Trading Company are $385,000, and the ratio of these assets to sales is over six to one; the test is favorable to the company's profitable operations.

The merchandise and receivables ratios will vary with the terms on which the merchandise is sold. We may assume that the sales terms are thirty days, 1 per cent in ten days; the merchandise should then have an increased turnover; the receivables carried on the books at any time should not amount to more than twenty-five days' business, and a small portion only should be past due. To the contrary, where the terms of sale are ninety days or longer, the merchandise will have a smaller turnover; the receivables will increase, and profits must be calculated in larger sums to take care of the extra hazards.

The liquidation ratios will now be taken up and considered; they are intended to measure the static condition of a business. These ratios are the tools of credit management to determine with reasonable accuracy the safety of payables and capital in going concerns.

The percentage of net worth represented in depreciation reserves is a primary liquidation ratio; reserves should vary with the nature of the enterprise and its natural hazards. The balance sheet of the Home Skill Trading Company reveal a reserve equal to 1 per cent of its capital. This is not sufficient; the reserve should be at least 4 per cent. Some industries with large plant accounts carry reserves of 8 per cent and more.

The major liquidation test is the ratio of current assets to current liabilities. The nature of the business and its hazards are the controlling influences in determining what the ratio should be; it is usual in credit practice to consider a ratio of two dollars of current assets for one dollar of current liabilities as ordinarily safe. The Home Skill Trading Company claims in its balance sheet current assets of $1,250,000 and current liabilities of $420,000. These figures establish a ratio of three to one and the company under this test is a good liquidating risk.

The ratio of cash to current liabilities is among the ranking liquidation tests. Safety and ease of liquidation demand at least one dollar of cash available for four dollars of current liabilities; a larger percentage of cash would increase the liquidating safety, but a very high percentage of cash might affect earnings. The company whose affairs we are studying has one dollar of cash for eight and one-half dollars of current liabilities, and manifestly is in a weak cash position. The remedy for this is a reduction of merchandise and a proportional increase of its cash holdings.

Liquidation ability is determined also by the proportion of net worth invested in fixed assets. If the ratio of fixed assets to net worth is disproportionate, then too large a share of the capital has been invested in fixed assets which are subject to heavy depreciation. A safe ratio in ordinary situations is one dollar of fixed assets for two dollars of net worth. The Home Skill Trading Company has three dollars of net worth for one dollar of fixed assets, and this test, therefore, is amply met.

The next ratio comparison is of the entire indebtedness with net worth. One dollar of debt for three dollars of net worth is deemed safe. The Home Skill Trading Company has one dollar of debt for slightly less than three dollars of net worth; this test reveals a little weakness in the company's financial set-up.

Wise financial management is displayed by surrounding invested capital with a reasonable surplus, which should represent 20 per cent of the invested capital. The balance sheet we are reviewing reveals a surplus of approximately 14½ per cent of the capital. Should the company's earnings continue to mount in the same proportions as the operating statement indicates, and dividends are not increased, the surplus will soon reach the safe figure.

Experienced credit managers have evolved other formulas than those we have presented. The professional nature of credit management does not permit standardized practice in ratios; good sense and professional skill are the best and safest guides in measuring the dimensions of credit and in applying the earning and depreciation tests.

The Property Statement Questionnaire.—Other information relative to features of a business is asked for in property statements. This information serves to clarify the qualities of a credit aside from the operating and financial figures. It is important that the credit manager should know whether the statement represents actual inventory or is merely a guess.

In the statement will appear these questions:

Do you keep books of account?

When did you last take inventory?

How much insurance on merchandise and equipment?

How much insurance on buildings?

How much liability insurance?

Is any insurance assigned?

Other pertinent questions appear on the property statement form; if they are accurately answered, the credit manager will have a fair perception of the conditions under which the business is operating.

False Financial Statements.—To serve as a true measuring-rod the financial statement must be honest and accurate; even if fraud is not intended, debtors may be led by pressure of circumstances to indulge in window-dressing when submitting their statements.

A practical credit technic demanded the protection from fraud of this important source of information, and eventually a model False Financial Statement law was drafted, simplifying prosecution procedure and making the offense a misdemeanor. The National Association of Credit Men and the American Bankers Association have collaborated in pressing for the enactment of this law in all of the states. At present false financial statement laws, similar or approximately similar to the model law, have been enacted in thirty-five states, and the protection accorded by these statutes has greatly aided in the circulation of financial statements; they have indirectly assisted in the great expansion of our financial and mercantile credit exchanges; they have also furthered the constant objective of credit management to place all business ventures on accurate charts. The operating and financial statements to serve as useful tools of the credit manager must reflect exactly the velocity of operation and the financial dimensions of a business.

CHAPTER XI

THE CREDIT MANAGER'S TOOLS—CREDIT EXPERIENCE INTERCHANGE

Early Credit Methods.—The credit transactions that figured in the early periods of our commerce involved some knowledge of the buyer's or the borrower's ability to redeem their agreements to pay; the need of this knowledge has increased with the expanding problems of modern commerce.

Business in our early years was largely a community affair and confidence in the safety and integrity of a debtor was founded on personal knowledge. His reputation may have been based on a debt-paying record, or it may have been based solely on personal impressions. It can be presumed that the credit commerce of our early period was largely dependent upon this dead-reckoning process, but this primary method of credit control had to yield to more certain methods when credit began to extend over wide areas.

Credit Evidence.—The expansion of business could not have been accomplished unless there developed sources of reliable information for the safe granting of credit. It had been reasonably safe to depend upon personal contacts and impressions for short-distance credits, but the dangers from depending upon this method when credit distances grew were naturally apparent. In the process of weighing credit information, the first step was to learn how the applicant had treated others; no evidence was more fundamental in the measurement of a credit than this.

Credit experience is tangible evidence for appraising the elements of a credit and the extent to which its dimensions measure up to the three C's; if the actual credit experience can be reached, there is no information of greater value in the intelligent treatment of a credit.

Credit Experience Interchange.—In making credit experiences available to credit departments, the presumption was logical that if the applicant had met his obligations to others in a satisfactory way, he would be equally satisfactory in paying a new obligation. On the other hand, if the applicant had been slow in paying his debts; if he was guilty of taking unearned discounts; if he habitually returned goods without cause, there would be good reason to feel that he would treat a new account in the same way; and if the applicant had been refused a credit accommodation, the fact and the reason were important information for the newly interested credit department.

How to reach the experience and to get it into circulation was a perplexing problem for credit administration; locating the credit experience was one horn of the dilemma; securing its accurate divulgence was the second horn.

Experiences were at first located by the practice of expecting new buyers to furnish references. This method proved imperfect; the references furnished by buyers would usually be those houses where their best accounts were kept, and in many instances they would not be indicative of their paying habits and financial abilities.

The second phase of the credit problem, securing an accurate and complete divulgence of the credit experience, had to contend with prejudices and misconceptions.

The shrewd business leader of our midperiod could see no advantage in giving accurate and complete information on prized accounts. Ambiguous and doctored information would many times be given as a means to transfer an undesirable account to the ledger of a competitor; a stilted phrase, "We regard the buyer good for his requirements," amounted frequently to nothing more than "window-dressing" for the purpose of unloading a languishing account. Cooperation was accorded no trial during that period; it was a battle of individual wits. The "spirit of the pack" was undreamed of in credit experience interchange; the fact was not recognized that the absence of safe credit appraisals retarded commerce, and selling goods at long distances had to be left to the strongest distributors.

Credit experience as evidence for testing the strength of a risk has no substitute; when comprehensive and accurate it will reveal the character and capacity elements of a credit. The capital element can many times be determined by implication.

After its organization in 1896, the National Association of Credit Men adopted as its first vigorous policy the freeing of credit experience interchange from the shortsightedness that had prevented its usefulness. Cooperation was given a sincere trial; dependability was substituted for deception, and accuracy for vagueness in divulging credit experiences. The new idea brought about so marked an improvement in commercial dealings that no desire has ever been seriously expressed for a return to the old methods. The improvement was an astonishing revelation to the old-fashioned credit managers, and they were genuinely surprised to find that credit experience truthfully circulated was an investment that brought substantial rewards. The value of credit experience information has constantly grown in the esteem of credit departments; it is indispensable evidence today, and by some managers is rated as more valuable than any other credit information available.

The Rules of Credit Experience Interchange.—The next step in organized credit management was to protect the information against abuses, and a cordon of strong rules had to be thrown around it for protection.

A large part of our credit commerce is based upon confidence in the interchange of credit experience. The importance, therefore, of keeping this tool of the credit department in an effective condition led to the setting down of strong, protective rules by mutual understanding.

The credit department that asks information must also give information; it should, coincident with the request, divulge what its experience has been with the subject; should the inquiry be made on a first order that fact ought to be divulged.

The inquiry must be made on actual new business or a ledger account. This is an important rule of interchange, as the service must not be utilized for "fishing" expeditions. Should the inquiry be made on a prospective customer and not on actual business in hand, reciprocation is not possible. No objection may be offered if the inquiring department tenders a proper explanation with the inquiry, but answering an inquiry of this nature is not compulsory.

Confining requests for information to proper cases is also an important rule; the interchange service would be badly hurt if indiscriminate inquiring were not discouraged. It is improvident to abuse or weaken a source of information that credit ingenuity might be unable to replace.

One of the strongest of the ethical rules is that exact experiences must be furnished in response to proper inquiries. A credit manager may feel reluctant to disclose information that may result in the transfer of a prized account, or to tell about an account that has become decrepit and is being nursed. It does not matter how genuine the reluctance is, exact facts must be disclosed; credit managers jeopardize their positions in credit circles when they knowingly violate the rule.

Credit experience inquiries should be answered promptly, and only by a member of the credit staff; frequently quick action on a credit transaction is demanded, and to neglect answering promptly might imperil the business.

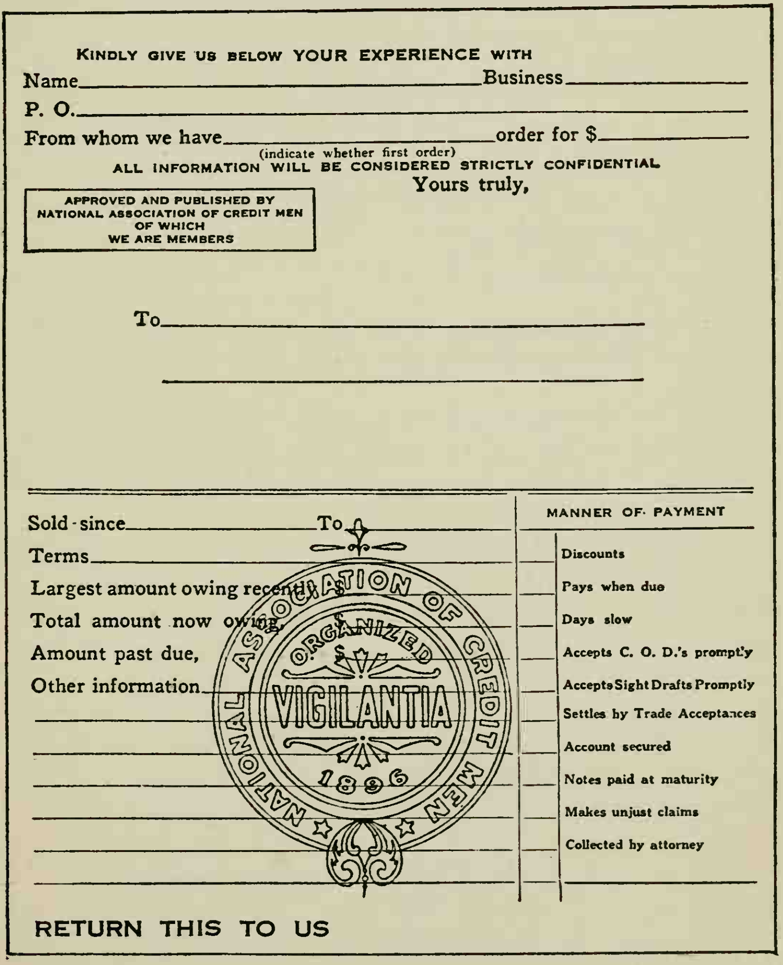
Credit information of an important nature may not appear on the ledger; neglecting to give such information is a serious offense against the cardinal rules of interchange. The capstone of credit interchange is that complete confidence must be accorded the inquiry and the response, and the violation of this rule of cooperation is inexcusable.

The confidential treatment of inquiry and answer is intended to keep any disclosure of the correspondence from seeping through to the subject. To safeguard the information is the responsibility of everyone who has access to the credit files.

Credit Interchange Methods.—The houses in his immediate locality were first resorted to by the credit manager or an assistant by personal calls, and after their information had been recorded it would be used in a consideration of the buyers. This plan was laborious; it still exists in some communities, but in a limited way.

Inquiries were made by mail of out-of-town credit departments. A form request was made for the experience of the credit department addressed, with the concern named, and a space or separate sheet was provided for the answer; these inquiry forms were rarely accompanied with the reciprocal information.

Below is the model inquiry form of the National Association of Credit Men:



KINDLY GIVE US BELOW YOUR EXPERIENCE WITH

Name________________ Business__________

P. O.________________________

From whom we have____________ order for $________

(indicate whether first order)

ALL INFORMATION WILL BE CONSIDERED STRICTLY CONFIDENTIAL

Yours truly,

APPROVED AND PUBLISHED BY
NATIONAL ASSOCIATION OF CREDIT MEN
OF WHICH
WE ARE MEMBERS

To________________________

____

Sold-since__________ To__________

Terms____________________

Largest amount owing recently $________

Total amount now owing, $________

Amount past due, $________

Other information________________

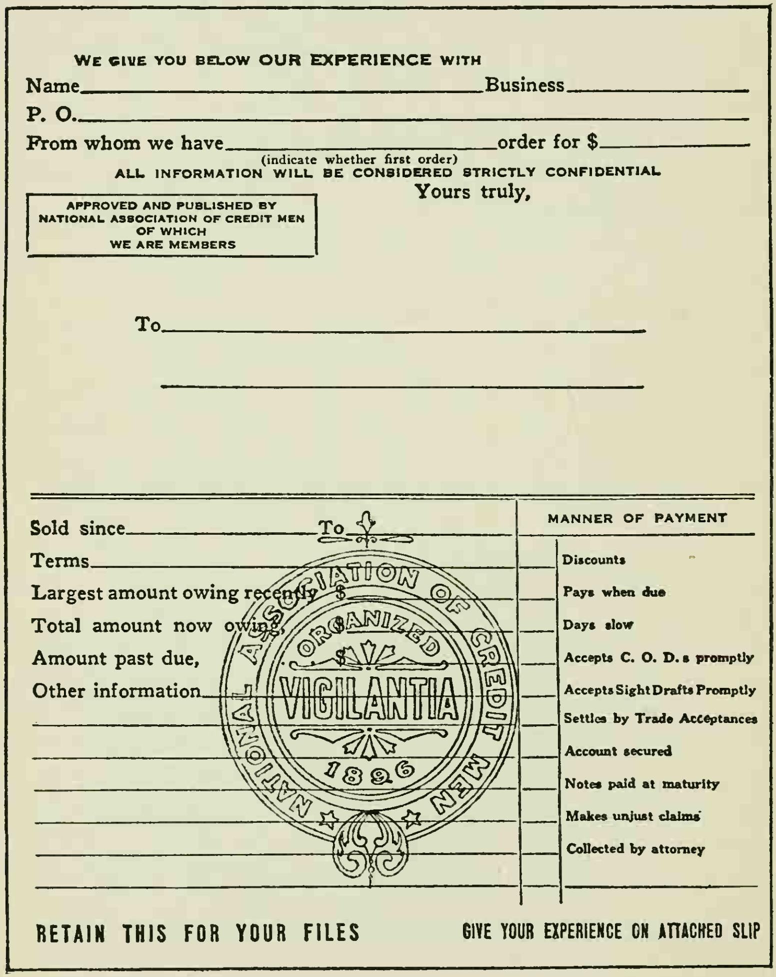
MANNER OF PAYMENT

____ Discounts
____ Pays when due
____ Days slow
____ Accepts C. O. D.'s promptly
____ Accepts Sight Drafts Promptly
____ Settles by Trade Acceptances
____ Account secured
____ Notes paid at maturity
____ Makes unjust claims
____ Collected by attorney

RETURN THIS TO US

The questionnaire of this model form touches the vital parts of credit transactions. The largest line of credit involved—indebtedness owing, due and past due—is important evidence for the basing of new accommodations. The paying qualities and the ethical qualities of the subject are contained in the form.

Credit Interchange Bureaus.—In 1890 there were 1,110,000 business concerns in the United States; in 1929 the number



WE GIVE YOU BELOW OUR EXPERIENCE WITH

Name ____________ Business ____________

P. O. ____________

From whom we have ____________ order for $ ____________
(indicate whether first order)

ALL INFORMATION WILL BE CONSIDERED STRICTLY CONFIDENTIAL

Yours truly,

APPROVED AND PUBLISHED BY
NATIONAL ASSOCIATION OF CREDIT MEN
OF WHICH
WE ARE MEMBERS

To ____________

____

Sold since ____________ To ____________

Terms ____________

Largest amount owing recently $ ____________

Total amount now owing, $ ____________

Amount past due, $ ____________

Other information ____________

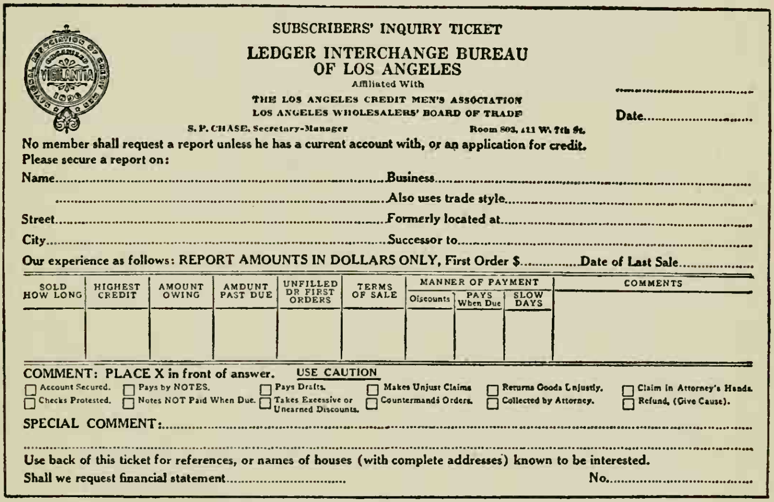
MANNER OF PAYMENT

- ___ Discounts
- ___ Pays when due
- ___ Days slow
- ___ Accepts C. O. D. s promptly
- ___ Accepts Sight Drafts Promptly
- ___ Settles by Trade Acceptances
- ___ Account secured
- ___ Notes paid at maturity
- ___ Makes unjust claims
- ___ Collected by attorney

RETAIN THIS FOR YOUR FILES

GIVE YOUR EXPERIENCE ON ATTACHED SLIP

had increased to 2,212,000. This increase imposed heavier demands on credit departments, as with the advance in prices after 1913 the larger number of credit accounts resulted in a heavy increase of dollar exchanges; a distribution of goods in 1890 reaching a total of one million dollars involved the same quantity of merchandise that would represent at least two and one-half times that sum in 1929. The old methods of gathering credit information were forced to give way under this situation, and the idea developed of assembling ledger experiences by means of a bureau. This piece of credit machinery is one of the highest expressions of organized credit management; it is sustained by cooperation and consistent adherence to the ethical rules of interchange. The bureau plan had to pass through several stages of development, and further improvements in its operations may be anticipated as new demands for the service develop.



SUBSCRIBERS' INQUIRY TICKET

LEDGER INTERCHANGE BUREAU
OF LOS ANGELES
Affiliated With
THE LOS ANGELES CREDIT MEN'S ASSOCIATION
LOS ANGELES WHOLESALERS' BOARD OF TRADE
S. P. CHASE, Secretary-Manager Room 803, 411 W. 7th St.

Date....................

No member shall request a report unless he has a current account with, or an application for credit.
Please secure a report on:
Name.................... Business....................
.... Also uses trade style....................
Street.................... Formerly located at....................
City.................... Successor to....................
Our experience as follows: REPORT AMOUNTS IN DOLLARS ONLY, First Order $.............. Date of Last Sale....................

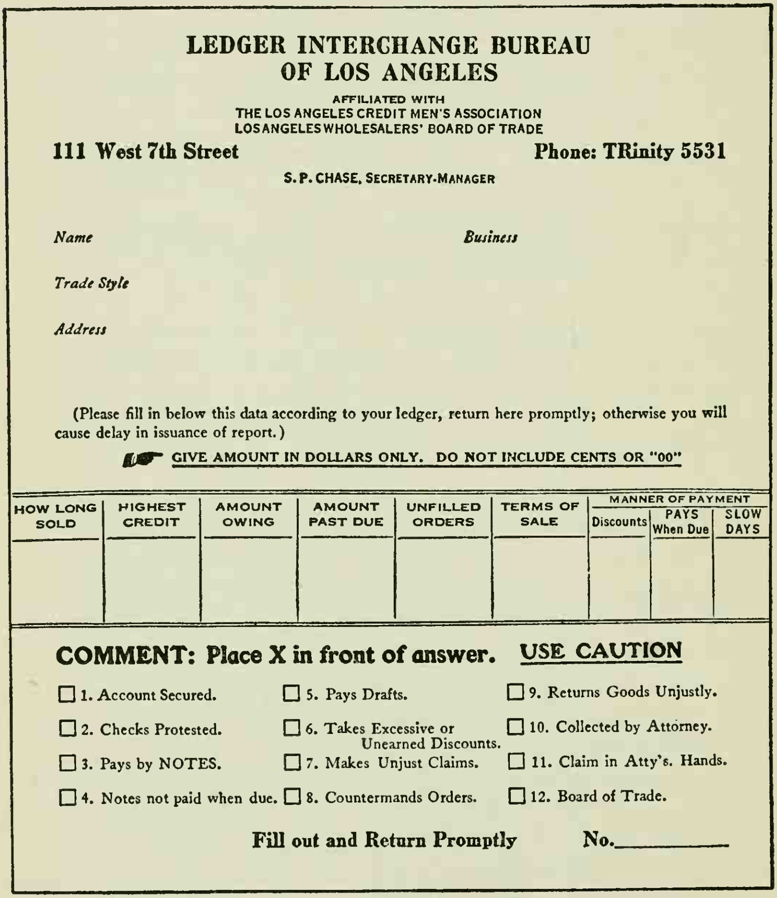
SOLD HOW LONG	HIGHEST CREDIT	AMOUNT OWING	AMOUNT PAST DUE	UNFILLED OR FIRST ORDERS	TERMS OF SALE	MANNER OF PAYMENT			COMMENTS
						Discounts	PAYS When Due	SLOW DAYS	

COMMENT: PLACE X in front of answer. USE CAUTION

☐ Account Secured. ☐ Pays by NOTES. ☐ Pays Drafts. ☐ Makes Unjust Claims ☐ Returns Goods Unjustly. ☐ Claim in Attorney's Hands.
☐ Checks Protested. ☐ Notes NOT Paid When Due. ☐ Takes Excessive or Unearned Discounts. ☐ Countermands Orders. ☐ Collected by Attorney. ☐ Refund, (Give Cause).

SPECIAL COMMENT:....................
....
Use back of this ticket for references, or names of houses (with complete addresses) known to be interested.
Shall we request financial statement.................... No....................

The credit department is relieved by the bureau of the work involved in making direct inquiries. One inquiry to the bureau will bring, usually, a flow of information for which a number of direct inquiries would have been necessary; the bureau covers a wide field and ferrets out experiences that the inquirer might not otherwise have discovered. A price is charged for the service to cover the operating costs under capable management. A number of bureaus are being operated by local associations of credit men and bureaus have also been established by some independent credit organizations and trade associations. The bureau plan is based on an agreement that each subscriber will file with the bureau a complete list of his customers, and in addition add the names of new buyers as they are accepted.



LEDGER INTERCHANGE BUREAU
OF LOS ANGELES

AFFILIATED WITH
THE LOS ANGELES CREDIT MEN'S ASSOCIATION
LOS ANGELES WHOLESALERS' BOARD OF TRADE

111 West 7th Street **Phone: TRinity 5531**

S. P. CHASE, SECRETARY-MANAGER

Name *Business*

Trade Style

Address

(Please fill in below this data according to your ledger, return here promptly; otherwise you will cause delay in issuance of report.)

☞ GIVE AMOUNT IN DOLLARS ONLY. DO NOT INCLUDE CENTS OR "00"

HOW LONG SOLD	HIGHEST CREDIT	AMOUNT OWING	AMOUNT PAST DUE	UNFILLED ORDERS	TERMS OF SALE	MANNER OF PAYMENT		
						Discounts	PAYS When Due	SLOW DAYS

COMMENT: Place X in front of answer. **USE CAUTION**

☐ 1. Account Secured.
☐ 2. Checks Protested.
☐ 3. Pays by NOTES.
☐ 4. Notes not paid when due.
☐ 5. Pays Drafts.
☐ 6. Takes Excessive or Unearned Discounts.
☐ 7. Makes Unjust Claims.
☐ 8. Countermands Orders.
☐ 9. Returns Goods Unjustly.
☐ 10. Collected by Attorney.
☐ 11. Claim in Atty's. Hands.
☐ 12. Board of Trade.

Fill out and Return Promptly **No.__________**

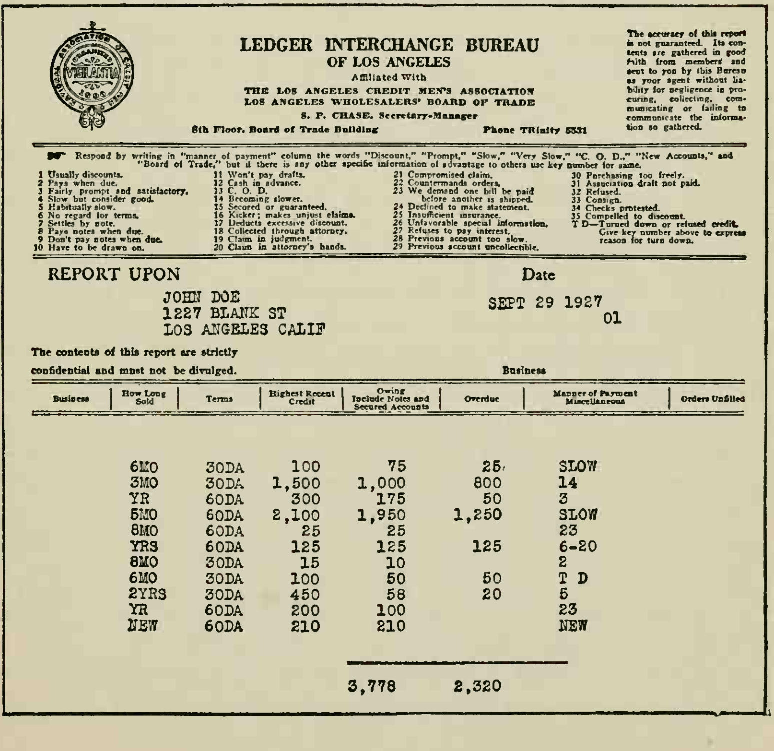
These names are carefully and confidentially guarded by the bureau; they are not accessible to other subscribers.

The service is initiated by the subscriber sending to the bureau an inquiry in the form of that on page 93.

The bureau upon receiving the inquiry ascertains from its files the names of other subscribers interested in the account. An inquiry is sent to each in the form of that on page 94.

Should the bureau know of nonsubscribers interested in the account an inquiry will be addressed to each of them, upon agreement to furnish a copy of the completed report in reciprocation for any information they may furnish.

When the answers to these inquiries are received, the information is tabulated in the following form:



LEDGER INTERCHANGE BUREAU
OF LOS ANGELES
Affiliated With
THE LOS ANGELES CREDIT MEN'S ASSOCIATION
LOS ANGELES WHOLESALERS' BOARD OF TRADE
S. P. CHASE, Secretary-Manager
8th Floor, Board of Trade Building **Phone TRinity 5531**

The accuracy of this report is not guaranteed. Its contents are gathered in good faith from members and sent to you by this Bureau as your agent without liability for negligence in procuring, collecting, communicating or failing to communicate the information so gathered.

☞ Respond by writing in "manner of payment" column the words "Discount," "Prompt," "Slow," "Very Slow," "C. O. D.," "New Accounts," and "Board of Trade," but if there is any other specific information of advantage to others use key number for same.

1 Usually discounts.
2 Pays when due.
3 Fairly prompt and satisfactory.
4 Slow but consider good.
5 Habitually slow.
6 No regard for terms.
7 Settles by note.
8 Pays notes when due.
9 Don't pay notes when due.
10 Have to be drawn on.
11 Won't pay drafts.
12 Cash in advance.
13 C. O. D.
14 Becoming slower.
15 Secured or guaranteed.
16 Kicker; makes unjust claims.
17 Deducts excessive discount.
18 Collected through attorney.
19 Claim in judgment.
20 Claim in attorney's hands.
21 Compromised claim.
22 Countermands orders.
23 We demand one bill be paid before another is shipped.
24 Declined to make statement.
25 Insufficient insurance.
26 Unfavorable special information.
27 Refuses to pay interest.
28 Previous account too slow.
29 Previous account uncollectible.
30 Purchasing too freely.
31 Association draft not paid.
32 Refused.
33 Consign.
34 Checks protested.
35 Compelled to discount.
T D—Turned down or refused credit. Give key number above to express reason for turn down.

REPORT UPON

JOHN DOE
1227 BLANK ST
LOS ANGELES CALIF

Date
SEPT 29 1927
01

The contents of this report are strictly confidential and must not be divulged.

Business

Business	How Long Sold	Terms	Highest Recent Credit	Owing Include Notes and Secured Accounts	Overdue	Manner of Payment Miscellaneous	Orders Unfilled
	6MO	30DA	100	75	25	SLOW	
	3MO	30DA	1,500	1,000	800	14	
	YR	60DA	300	175	50	3	
	5MO	60DA	2,100	1,950	1,250	SLOW	
	8MO	60DA	25	25		23	
	YRS	60DA	125	125	125	6-20	
	8MO	30DA	15	10		2	
	6MO	30DA	100	50	50	T D	
	2YRS	30DA	450	58	20	5	
	YR	60DA	200	100		23	
	NEW	60DA	210	210		NEW	
				3,778	2,320		

This specimen report discloses eleven experiences. The open indebtedness amounts to $3,778, and of this $2,320 is overdue. The report reveals a slow-paying merchant; there are earmarks of danger to be found in every corner of the report.

Central Bureau Interchange.—The evolution naturally followed of binding local interchange bureaus into a central system. The smallest merchant is often induced to place orders at long distances from his location; hence a better reflection of a merchant's credit condition and paying habits can be found by tracing his accounts into the markets where his principal buying is done. A ledger review in the seller's market might disclose a mere fragment of the buyer's transactions.

A super-bureau for central interchange was within the reasonable powers of the National Association of Credit Men to erect and its effectiveness is being constantly demonstrated. The local affiliated bureaus send to the central bureau in St. Louis the customers' names furnished by their subscribers. Thus there are listed in the files of the central bureau about two million names, and not many business enterprises in our country can escape its detection.

The plan pursued is for a local bureau, when receiving an inquiry, to send the name of the subject to the central bureau, whose files will reveal in what other markets the buyer has done business. The bureaus in those markets will be requested by the central bureau to send copies of their latest reports to the bureau making the new inquiry, and the latter will be informed by the central bureau from what other bureaus reports should be expected.

As a result of this systematic procedure the final report furnished will contain experiences spread over several markets. Nothing more useful and complete in the field of credit experience interchange has been developed as a practical guide to safe credit work.

Trade Groups.—The value of credit experience interchange and the added value of direct contacts for humanizing the interchange have resulted in groups of credit managers in similar lines meeting at brief intervals for the discussion of difficult and backward accounts. The group idea has become highly popular and a large number of them are now successfully operating. They are not operated on a uniform plan; the problems peculiar to each industry will determine the manner in which its group will operate, and where the credit risks demand close watching the group conferences are usually very beneficial.

Complete confidence and cooperation are essential to effective group operation. Information is divulged and discussions occur with a candor that brings difficult accounts into the open; the group conferences will often result in concerted action to save the debtor or to save the creditor when the searchlight of scrutiny reveals a serious situation. The direct contact of credit managers permitted by the group conferences promotes the mutuality of obligations that credit departments should feel in carrying forward constructive credit work.

CHAPTER XII

THE CREDIT MANAGER'S TOOLS—MERCANTILE AGENCY REPORTS

The Development of Agency Service.—With increasing facilities for transporting goods, broadened trading areas brought about new financial and credit needs. Assembling information for credit transactions by individuals was difficult and expensive and not sufficiently flexible to satisfy the growing pressure of business, and after the devastating panic in 1837 a bureau for credit information was organized in New York City. As a development of this service for mercantile reporting, there appeared a reference book as an added facility. The appearance of this reference book in the early 'forties was a distinct step in the evolution of credit-information sources. With the impetus of this new development in organized service Bradstreet began to operate in 1849; R. G. Dun & Co. was founded and began operations in 1859.

The mercantile agencies are the allies of credit departments in gathering certain types of evidence, and both agencies cover the country by networks of offices. The mercantile agencies employ large staffs of reporters to interview merchants and to inquire into their reputations, antecedents, and paying records; correspondents are used to gather information in localities that are inaccessible to reporters; offices and reporting services have been established in foreign countries as a credit aid to exporters. The widespread operations of the agencies make accessible to users of their service information on buyers located far away.

The information gathered by the agencies is revised at brief intervals, for probably nothing changes more rapidly than ill-managed and underfinanced business enterprises. The data gathered by the mercantile agencies possesses distinctive features; some of the information is not available through other channels. The agency report holds a unique position in the evidence gathered by credit managers when measuring the credit proportions of an applicant or when re-measuring old accounts.

Preliminary Agency Information.—The correct name of the individual, partnership, or corporation written up will appear at the top of an agency report; the exact street address, the city and state where the business is located, will be furnished also as initial information. This detailed information helps credit managers to detect mistakes made by salesmen in recording orders, and it serves frequently to prevent the perpetration of frauds.

Financial Information.—The mercantile agencies endeavor to obtain financial statements from all mercantile enterprises. The financial statement, when prepared in proper form and when it is a copy of accurate inventory records, is considered by subscribers as one of the most helpful features of agency reporting.

The large business enterprise will seldom object to divulging its inventory figures, and copies of balance sheets are sent regularly by many business enterprises to the mercantile agencies for inclusion in their reports.

Small business operators will frequently object to the disclosure of their balance-sheet figures, and a large number of enterprises have no accurate figures on which dependable financial statements could be based.

It will happen at times that the agencies will receive financial statements drawn in round figures, and reporters will often draft financial statements based on approximate figures furnished them in personal interviews. These forms of financial statements are mere guesses and should carry no weight as credit evidence. The agency report will usually indicate the sources from which a financial statement has been prepared.

Following the financial statement presented, the agencies will offer their comments on the financial showing. The opinions of agency reporters on the dependability of the figures disclosed are of assistance to credit managers. This is particularly true when the figures in an agency report are the only balance-sheet figures available.

The financial condition paragraph will, as a rule, indicate the closeness with which the present statement agrees with figures formerly furnished. An opinion will also be offered on the extent of shrinkage that the assets may warrant, and there will appear finally an estimate of the subject's net worth. When this paragraph of the agency report has been carefully compiled and is complete, the credit manager is placed in possession of usable evidence for measuring the capital dimensions of a credit risk.

Insurance Summary.—Protecting the assets of a business against the hazards of fire and casualties is an important feature of good management. Arousing debtors to the perils of fire hazards, and the need to protect themselves and their creditors is an urgent responsibility of credit management.

The casualty hazard has grown in credit importance during the past two decades. The law now views jealously casualties occurring to employees or to outsiders on business premises. Insurance against the causalty hazard is important to the safety and welfare of a business. The knowledge that this protection exists is desirable evidence for the credit manager to possess and the mercantile agencies may be his only source of information.

The custom has evolved for officers of corporations and individual owners to take out life insurance for the benefit and protection of the business; the life policies of this type represent a huge volume of protection to business enterprises and to creditors.

Trade Opinions.—This feature of the agency report has aroused a warm debate in credit circles. Trade opinions are ledger experiences gathered by the agencies from interested houses, covering usually three experience features—high credit, manner of payments, amount owing. Each experience is concluded with the comment, if any, of the informing house.

The attitude taken by many credit managers is that the reciprocal feature is not observed in the agency's method of assembling ledger experiences; that the experience information gathered by the agencies lacks the completeness and certainty assured in the interchange carried on between credit departments direct, or by their bureaus. The position is taken by some managers that the agency's trade opinions may be old and for that reason are not a dependable reflection of the debtor's immediate obligations and paying habits. In credit circles, old ledger experiences are considered of doubtful value.

The criticisms of credit managers of this feature of agency service have good foundations. Trade opinions cannot be assembled in the absence of reciprocal arrangements, with the certainty and dependability possible in other features of agency reportorial work. Many users of mercantile-agency service have advanced the opinion that the time and expense devoted to gathering trade opinions could be more profitably devoted to other features of the reporting service.

Antecedents.—This is a feature of agency reports that gives them great value in credit investigations. Determining the character and capacity elements of a credit can be largely assisted by a knowledge of the former occupation and the personal record of the applicant. The ease with which any person, or group of persons, can go into business and the difficulties that will be encountered make important a knowledge of what the enterprisers have done to fit them for the task and to entitle them to credit favors.

In illustration: A credit manager is considering a first order of large amount from a retail clothing store. The business has been operating seven years; the financial figures revealed to the agencies show a proportion of current assets to current liabilities of four for one. The antecedents paragraph gives a brief history of the owner's career; the significant feature is that for several years before opening business for himself the owner had been a salesman in a retail clothing store, so that the training had fitted him for an owner's position. A comparison of the financial figures disclosed in the report with former statements furnished to the agencies revealed a continuous progress. Everything in the report, and especially the information on antecedents, tends to make the risk acceptable.

Another illustration: An applicant for a line of merchandise on credit terms has been in business one year. The agencies estimate his financial worth at a figure that ordinarily would warrant the credit accommodation applied for, but antecedent information revealed that the applicant had formerly practiced law and was without any mercantile training when setting up the business enterprise. This risk is intensified in the light of the antecedent information; a question will arise in the mind of the credit manager concerning the applicant's capacity. Does he possess the material out of which merchants are made? The order may be accepted, but the prudent credit manager will mark the account for close watching, and should any earmark of recession appear he will take immediate action.

It will sometimes happen that interchange reports disclose a consistent discounting record. The agency report in its antecedent information will show the subject to be of poor birth and with an undesirable record; the inference is justified that the discounting record is designed for ulterior purposes.

Antecedent information is likely to disclose whether the subject has been guilty of mercantile misconduct and may qualify velocity and liquidation figures. Antecedent information may diminish the value of experience interchange, and is highly important evidence when the acceptability of a credit is on trial.

Fire and Water Losses.—This paragraph of the agency report will tell if any fire or water losses were sustained by the subject. It will also disclose whether the losses were covered by insurance and amicable settlements were made with insurers. The fire record is useful evidence to measure the character element of a credit.

General Remarks.—This will offer the reporter's impressions of the business and the owner; neighborhood impressions of the business and its qualities are frequently embraced.

To illustrate: "The subject is considered a good business man; he has had experience in buying and financing. From a start in a meager way, the business has grown to large and profitable proportions." The paragraph may further say that "the business premises are well located and present a good appearance."

The touches offered in this paragraph concerning features of the credit risk that are not furnished through other sources are of assistance to the credit manager; they permit him to see certain aspects of the subject and his surroundings through the eyes of agency reporters.

The Agency Reference Book.—The mercantile agencies compile and issue at fixed periods reference books containing the names of all the country's business enterprises. The names are listed according to localities and states, with a capital and a character rating appended to each listed enterprise. When a rating is missing the subscriber understands that for some reason none has been assigned; the ratings are based upon information gathered by the agencies.

The reference books are widely used by credit managers for general credit guidance. The ratings are not intended to take the place of compiled reports; thousands of changes occur daily among business enterprises, and therefore the ratings assigned may not be an immediate reflection of the risk.

The Value of Mercantile Agency Reports.—The value of agency evidence in credit management is in direct ratio to the carefulness and the completeness of the reporter's work. The operating statement and the copy of the balance sheet, when obtained direct, express a certainty that emphasizes their value as evidence in credit investigations.

The credit experience is now protected by strong ethical rules of interchange, and it represents an accurate picture of much value as credit evidence. The agency report is compiled beyond the direct control and supervision of subscribers; its service as a credit guide will rest upon the care and skill exercised in gathering the information it discloses.

Mercantile agency service is unquestionably an important tool of good credit management; through no other channels can there be obtained certain types of information needed to complete the picture of a credit risk. On the other hand, the mercantile agencies can improve their service by providing the evidence they are best qualified to gather. Expending their resources and labor in gathering information that can be more accurately and economically assembled by other methods is improvident and unwise.

Interpreting the Mercantile Agency Report.—Every type of credit evidence must be intelligently interpreted by the credit manager. The operating statement and the balance sheet convey no useful inferences unless they are carefully weighed and the proper comparisons made. The credit experience report must be properly read for a useful appreciation of the picture it presents. Similarly, the agency report must be read understandingly or its significance may be lost.

The net worth shown in a financial statement may be much larger than that estimated by the reporter. The occasion of this difference is a proper question of the credit manager. Can it be accounted for by a normal depreciation of assets, or is the difference large enough to cast reflection on the veracity of the statement figures? If the antecedent information discloses the fact that the subject had recently gone through bankruptcy, the question will be aroused as to the sources of the new capital invested in the venture. Did the circumstances savor of dishonesty?

The agency report is cumulative evidence; the information it contains should be compared with the information obtained through other sources, and when this comparison reveals discrepancies in figures and in facts the credit manager must seek to reconcile the differences or probe the occasion for them.

CHAPTER XIII

THE CREDIT MANAGER'S TOOLS—VARIOUS SOURCES OF INFORMATION

The Personal Interview.—The best results from this source of credit information are unattainable if the interview is not carefully developed and carried through; there are inherent dangers of irritation in a direct approach for credit information. A written request for financial or other credit data will irritate the recipient if the request is not thoughtfully and convincingly phrased; the possibilities of irritation are even larger in a conversation about matters that most people look upon as strictly private.

The approach to an interview will determine its success. The person interviewed must be put at ease by a good approach technic and disarmed of the suspicion that is likely to arise. Haphazard methods and poorly developed plans will defeat at the outset the purpose for which the interview is sought.

Assume an instance where the interview is intended to disclose to an applicant that his credit cannot be accepted. Though the self-interest motive is not prominent in this contact, the interview should be so courteously guarded that the door will not be permanently closed if the applicant were to improve his financial condition and become an acceptable risk.

There is no standardized method for the approach and conduct of an interview; the plan to be effective must be susceptible of variations, adapting it to differing cases. Some credit managers surround their interviews with an atmosphere of obvious pleasantries; unless the purpose is carefully guarded this manner of handling the interview may defeat itself. Generally, the interview that will prove most productive is a composite of directness, clearness, and courtesy.

The personal interview has a distinct and useful objective.

It is the most active generator of impressions that fit into the psychology of credit work, and can be utilized as a source of information that could not be obtained through other channels. The personal interview at the time an application is made for a charge account and during the continuation of an account, is a tool that can be used by the credit department to build business, prevent mistakes, and save losses.

It is customary in retail buying for the credit applicant to be interviewed by some member of the credit staff. The information usually sought in this interview is simple and personal; the applicant is questioned about sources of income, bank connections, and where other charge accounts have been established. In this interview no irritation or resentment should occur if the approach and treatment are direct and courteous.

Bank credit relations are established generally by the medium of interviews. The loan applicant may be less independent than the applicant for goods, but none the less good form should govern the financial interview. The finest instinct cannot foresee what the future may unfold; the loan applicant may be financially diminutive today and gigantic tomorrow.

The mercantile credit interview offers the widest opportunities for deft workmanship. In illustration: An applicant for a large credit account is just opening business; he has no paying record upon which experience interchange can draw; the mercantile agencies have not had time to compile a report. The purchase was made from stock, therefore an interview with the buyer was convenient; the disposition of a good order and the fate of future business hang upon the conduct of this interview. The credit manager will endeavor to ascertain the extent of the buyer's investment in the new enterprise and whether the investment is his own capital or partly borrowed. He will also endeavor to find out how much goods he proposes to buy and what his arrangements are to pay for them; the applicant's former vocation and other pertinent information will also be sought. A direct approach and courteous handling should put this applicant at his ease; clearly stated questions should bring the desired disclosures. If the proper technic has been observed and the buyer displays unwarranted irritation, the conclusion is justified that the account on credit terms is not desirable.

Interviews in various situations will fall to the credit manager. Looking an applicant over in the face-to-face contact permits the forming of deductions as to credit powers that cannot safely be created by any other medium.

Salesman Information.—This source of information does not command the high regard of all credit managers, but this does not lessen its possibilities for service.

The salesman maintains a personal contact with his customers and thereby enjoys an unusual opportunity to appraise their abilities. The observing salesman will mentally measure the condition of a buyer's stock, and it often happens that a customer will converse with a salesman about his financial affairs and problems. This source of information has not attained its possibilities because credit departments have neglected its cultivation. There are divergences between the sales temperament and the credit outlook, but their interests are joint and their objectives are similar. The success of the enterprise they serve should be the chief purpose of both.

Some credit departments supply salesmen with printed forms containing a series of questions that they are expected to answer from observation, or from inquiries of buyers. These forms are usually intended to convey information on first orders only. But the salesman should be an available and useful source of information at any stage of an account, and not alone at its inception.

The salesman most antagonistic to credit department methods cannot resist the potent fact that no profit is made until the receivables are converted into money. When he realizes that the chief end of credit management is to convert well-sold goods into collectible receivables, such a salesman will recognize the jointness of interest and the common task. The credit manager, to develop the salesman's assistance in his credit investigations, must understand the salesman's temperament and problems. This requires cooperative contacts, and time is well spent in such conferences with salesmen. The condition of customers' accounts can be frequently gone over. Whenever it is undesirable to increase a credit line, the reasons can be prudently disclosed in a conference; should a failure have occurred, the conditions and causes should be explained in an understandable way to the interested salesmen.

The sales manager exercises a helpful policy when the credit manager is invited to attend and to address meetings of his staff. Such opportunities should be utilized in the fullest way by credit managers to emphasize ways in which both departments can work together.

The majority of salesmen need to be shown the value of credit work and trained to gather the information that credit departments can use. Salesmen have been discovered who possessed a well-developed credit sense; when this occurs the credit manager enjoys a source of information safer to follow than the evidence he usually assembles.

The minor position held by salesman information in credit departments should not be permanent, and it need not be if proper attention and effort are devoted to its construction. The credit manager having interested and diligent scouts for earmarks of credit safety or danger holds a position paramount to one who has failed to develop this assistance.

Bank Information.—The bank as a source of credit information is not of uniform value. For reasons not difficult to apprehend, bank credit information has not been adjusted to the modern trend of complete cooperation in credit practice.

Out of approximately 28,000 banking institutions operating throughout our country, only a minority have sufficient capital to install credit departments, and information for credit uses in the mercantile field is largely limited to such institutions.

The bank experiences differ in nature from the mercantile experiences; its experiences are with deposits and loans; those of the mercantile house are with sales and payments. The manner in which a depositor maintains his bank account is information equal in credit value to the manner in which a merchandise account is kept. The promptness with which a borrower repays loans is information just as valuable in credit work as the manner in which merchandise payments are made.

The files of a bank credit department will usually be as complete in its assembled information on a borrower as the mercantile credit department would seek to build on a buyer. Where the bank is a community institution, it is highly probable that the depositor is known personally to its officers; they have had the opportunity of forming impressions of the credit risk from personal contact and observation.

The fluidity of the mercantile credit experience has been its chief virtue; no credit transaction is deemed too confidential for transmission to others under proper interchange conditions. The bank, however, regards as too confidential for disclosure certain of its transactions with depositors and borrowers. Conceding the tenability in part of this attitude, the fact remains that bank disclosures to mercantile credit departments do not always reflect the reciprocation upon which experience interchange rests.

The credit departments of mercantile houses may be somewhat responsible for this; unthinkingly they will make requests of banks for information on forms not adapted to the disclosure of bank experiences. The proper procedure is to ask by letter for the information desired, or by a form that is adapted to the credit experiences of banks. The reciprocal information should never be neglected when the inquiry is made.

The bank when approached in a proper way should disclose in response sufficient information to indicate with certainty the nature of its experiences. Exact deposit and loan figures may be reserved, but the bank's satisfaction with the account, the paying methods of a borrower, and any strained situation should be accurately disclosed.

Many small banking institutions manifest no sense of responsibility when answering credit inquiries, even though the bank may be dependent upon information of mercantile credit departments for their loan and discount transactions; but the credit managers of larger institutions are inclined to make useful disclosures in response to mercantile inquiries; and they are usually free in interchanging experiences with one another.

Attorney Information.—That the information gathered from attorneys for measuring credits is of doubtful value is not a reflection on the attorneys' attitude; they should not be expected to understand the elements of credit.

The attitude of an attorney toward the people and merchants of his community will frequently color the disclosures he is willing to make. Mutuality of interests does not exist between the credit department and the attorney that exists elsewhere.

Credit information should not be expected on a gratuitous basis. Reciprocation is its foundation; and if the attorney has not represented the inquirer in a professional capacity, or is not paid a fee for the information sought, a fair exchange will not take place. "Law lists" have been compiled and are offered to credit departments to be used for making inquiries of attorneys, on certain terms and conditions; these lists are not always used in conformance with the conditions.

On the whole, the attorney's information must be used carefully, and a minor position accorded it among the credit evidence available to credit managers.

Summary.—The tools that have been wrought for credit managers represent an evolution of effort to meet the requirements of an expanding commerce. The tools do not function perfectly, but they do good work when skillfully used; this is attested by a decreasing ratio of commercial failures. Though the credit waste of each year runs approximately one-half billion dollars, the ratio of loss to our total commerce has decreased since credit work became organized. Were the same ratio of loss to exist today that existed three decades ago, the sum would be staggering. Though the credit losses of 1896 were approximately 1½ per cent of our total domestic commerce, the ratio of loss in 1930 will not exceed three-quarters of 1 per cent. This comparison reveals the advance that credit management has made in the use of its tools.

At the turn of the twentieth century a gold dollar could render less service as a base for credit than it can at the present time. This increased service of gold is a direct result of a better understanding and skill in using credit tools. The further evolution of our trading abilities will depend no more on raw materials and fabricating genius than on an increasing power to adapt credit to a bigger task. The credit manager's tools are not complete; those he now enjoys can be improved and additional tools will be wrought.

CHAPTER XIV

CREDIT CORRESPONDENCE

The Dynamo of Credit Work.—The credit letter is more than a tool of credit management. It is the dynamic current that vitalizes the manager's tools, when the flow is properly maintained. The relation of good correspondence to good credit management is so direct that efficiency in management must include the ability to write good letters. Skillful correspondence marks the division between mechanical and professional credit work. Credit correspondence need not aspire to the realm of fine arts, but it is patent that many a mishap occurs because of poorly constructed letters. The occasion of the mishap may be attributed to any number of causes but the real one—a letter that failed to sell an idea.

Training for credit management is looked upon generally as the development of skill to distinguish good risks from bad risks; this skill is a dull tool without the capacity to reproduce the selective process in a well-constructed and convincing letter. Training for correspondence is the complement of training to use well the measuring-rods of credit, and the interrelation of the two must be preserved for the attainment of proficiency in managing a credit department.

The responsibility of credit management is to keep credit circulating at a minimum of hazard waste; the margin between the present wastage and that which might exist were more expertness exercised, may be accounted for in part by poorly controlled correspondence.

The Credit Department's Salesman.—The letter represents the credit department on a sales mission, the performance of which will depend upon the sales power of the letter. To illustrate: The information obtained about a buyer is not sufficiently convincing of the safety of the risk. The credit manager realizes that the buyer can supply the missing evidence through a copy of his latest balance sheet, which is, therefore, earnestly desired. The letter requesting the statement must be so constructed as to sell to the buyer the idea of furnishing it, and should the letter fail a cancellation is likely to result.

To illustrate again: A debtor has remitted for an account in twenty days and deducted a discount allowed in the sales terms for cash in ten days; the remitting debtor is financially able and satisfactory in his methods, except in taking unearned discounts. The alternatives are presented of submitting to the wrongful deduction, or selling to the debtor the idea that violating purchase terms is unethical; the letter composed by the manager must prove a good salesman of the ethical idea, or future business may be sacrificed.

Another illustration is the account dragging past maturity, which becomes a cost to the creditor, even though interest is allowed for the extended time. The collection letter has for its mission—selling to the debtor the idea of paying the account. If the letter lacks sales power, no response is likely to be received, or at the best an indefinite reply.

The credit department has in its varied operations many ideas to sell. The sale of a credit idea is often more difficult than the sale of merchandise. Keeping steadfastly in mind the sales mission of a credit letter, its composition should be directed to the purpose and made convincing.

Sending an unqualified salesman into the field to sell goods is no more foolish than to send a letter that possesses no sales qualities. The cost of poor credit letters is beyond approximate computation. The credit losses, delinquencies, and mishaps that are constantly occurring reflect defective salesmanship qualities in much of our credit correspondence.

Establishing a Contact.—The buyer approached by letter for a financial statement is unlikely to react favorably and to furnish the statement should the letter fail to establish a proper contact. The debtor violating discount terms will probably refuse to see the need of conforming to terms if the manager's letter fails to contact. The tardy debtor will not send the remittance asked for, if the collection letter fails to produce the desired reaction.

After constructing a letter of importance, the self-addressed question, How would I respond to such a letter? will generally measure for the writer its contact value. The manner in which a letter opens serves usually to establish a contact or to defeat its mission. Ill-fitting words and poorly constructed sentences in a credit letter are like unbecoming and badly made garments. They carry no power and will not command respectful attention.

Fitting the words to the ideas is a wise formula for credit letters and proves the best equipment for this representative of the credit department. This opening is sometimes found in collection letters:

> Will you kindly allow us to call your attention to the enclosed account?

There is a disguise of courtesy in this statement for the real idea that the letter was intended to sell; its transparency would prevent in most instances the making of a proper contact. There is no need or propriety in asking the permission of a debtor to request the payment of a past-due account; no one more than the debtor would recognize the anomaly of this overdrawn courtesy. The idea was a collection, and the account may have been a long time past maturity.

> Please favor us with check by return mail for the inclosed account that is long past due.

This is the approach that carries no disguise and is best constructed to register a contact.

The following form is used in some letters relating to orders withheld from execution for credit reasons:

> Concerning your valued order, we find it best to write you.

The verbiage of this approach lacks contacting power; it is a disguise that can be easily penetrated, and the words, "find it best," are without character in the letter. The words and the ideas must blend into one another and be reciprocally expressive if they are to establish the contact as a first step in successful correspondence.

Arousing Interest.—The credit letter will not perform its mission if it fails to arouse interest as a sequence of establishing a contact. The recipient of a letter, whose interest has been aroused, responds to its drawing power and is willing to entertain what the letter has to say; interest must first be aroused by asking for the financial statement before the request will be granted.

We may take in illustration the following "word garment" for such a letter:

> You know there is nothing so sensitive as credit, and it is necessary that debtor and creditor should understand one another.

This language expresses nothing more than a bit of pleasantry that in most cases would merely bring a cancellation.

The tardy debtor must be aroused by the collection letter and his interest must be stimulated so that a check will be mailed, or a dependable date set for payment. The sales quality of a collection letter will be in conformity with the debtor's temperament. There is no uniformity in phrasing collection letters, but their mission is uniform—to sell the idea of payment by establishing a contact and arousing interest. Directness must be adhered to in credit correspondence, no matter how ideas may be clothed; to apologize for asking a debtor to pay an overdue account is not good salesmanship in credit correspondence. Interest in the payment of a debt should be aroused by convincing the debtor that payment is expected and that it is proper to respond.

The idea of payment can be sold to some debtors by a simple request for remittance. Others will require stronger demands, and still others will respond to "stunt requests." An illustration of the "stunt" collection letter is the following message to a debtor who had ignored the usual requests for payment:

> How would you feel were you to awake one morning in a beautiful garden where fountains were playing, birds were singing, and dainty fairies were fanning you? That's just how I would feel to receive your check for our long overdue account.

The "stunt" collection letter is dangerous and has but a limited field in credit correspondence.

Avoiding Negatives.—Effectiveness in credit correspondence rests upon the strength and constructiveness of its suggestions, which comprise the drawing power of a letter.

Affirmative action is the proper mode of attack in making requests; the letter must convey no idea but that a proper response is expected. The suggestion of an alternative will serve too frequently to furnish an apology or a deferment. To illustrate, this form is frequently used in collection letters:

> Favor us with check by return mail, or if you cannot, please tell us when it may be expected.

The collection letter will sometimes be phrased in this form:

> We would appreciate your remittance for amount due or word as to when it may be expected.

The negatives in these two letters diminish their drawing power and sales value.

An affirmative collection statement is the following:

> The account is overdue on sales terms. Please favor us with check in settlement by return mail. This we know you will be pleased to do.

The credit letter must be affirmative; this form of letter will not give offense or defeat its mission if the suggestion is simply phrased and carries no appearance of disguise. The financial statement should be asked for in a manner that carries no inference of refusal; the statement is requested as a mutual service, and a favorable response is therefore anticipated. The affirmative form possesses drawing power when apologies and negatives would attract no response.

The Three "C's" of Credit Correspondence.—Time, effort, and material costs are sacrificed to indifferent and ineffective letters; contacts are not established, interest is not aroused, and results are not attained because letters fail in their missions.

To acquire skill in correspondence, individual effort is necessary with the aid of some simple standards; as such, the three C's are offered—clearness, conciseness, and courtesy.

Clearness.—Clearness involves the use of words and combinations of words that will picture clearly the writer's idea.

Muddying a correspondence stream by a writer's fear that his purpose may not bring the desired reaction, sacrificing clarity by an indulgence in platitudes intended to soften the letter's impact, unduly long and poorly constructed sentences, will usually submerge the writer's ideas in cloudy verbiage. An illustration of this has been found in some solicitation letters:

> We don't want you to feel that this request has any unfriendly bearing on our relations.

This statement is nothing more than a platitude, so transparent as to defeat the sales value of the letter.

Where the financial statement is needed for a proper estimate of the credit, and can be obtained only from the applicant or the debtor, the request will stand a better chance of success if it is phrased simply and clearly; collection letters too frequently offer reasons and apologies for asking payments that are entirely aside from the issue. This sentence is common to many collection letters:

> We are needing money and must, therefore, ask you for check.

Even though the creditor may need money, to state that condition as a reason for asking payment is out of place.

A fear of offending the debtor by asking for what is fair is not the attitude that will furnish the needed clearness to credit letters, and there are allied mental states, such as anxiety and irritation, of equal danger. The cultivation of clearness in letter-writing rests upon the exercise of careful execution; each letter should be studied as to its particular mission, and words selected that will exactly picture the writer's ideas.

The sales department would be improvident and neglectful to send a salesman into the field with a line of samples below the standard of the goods they are intended to represent. It is equally foolish for the credit department to send a letter on a sales mission with poor word samples. Clearness in a credit letter is the fundamental of its success.

Conciseness.—Conciseness is not the synonym of brevity; the concise letter is no longer, nor is it briefer, than the clear conveyance of its mission demands. The credit letter has a purpose. The simple "thank you" and the most intricate situations are subjects of credit correspondence, so that a standard of length cannot be applied. Brevity is the power of a letter conveying ideas that can be briefly stated, but the purpose of a letter must not be sacrificed to brevity.

Conciseness has for its purpose the avoidance of repetitions and meaningless statements; the objective in letter-writing sought is the statement of ideas clearly and completely, avoiding the use of platitudes and apologetic interjections.

In a letter requesting a financial statement, this treatment was found:

> This is a delicate matter to discuss. We don't often ask for a statement until we have tried to get the information in other ways.

Such an explanation is devoid of sales power and cannot establish the proper contact because its meaning is vague; the motivating purpose is clouded by an unnecessary and inartistic platitude.

In acknowledgment of an order, this statement will at times be used:

> It is a pleasure to have the opportunity of adding your name to our list of satisfied and prosperous customers.

Not many buyers would fail to recognize the transparency of this language; should the letter contain no other statement, its conciseness would be injured by an overexpressed appreciation.

The concise letter will present its purpose like a cameo—clear-cut and appealing. In illustration: the account of an old customer was becoming slow and the credit manager desired to get this account into the discount column. The following letter was sent:

> We regret that for several seasons you have not taken advantage of our discount terms. When a customer has dealt with us the length of time you have, we feel a sincere interest in his welfare. We wish to give him every advantage in prices, but this can't be done if his payments are not prompt. Send check for the overdue account and in the future give us the pleasure of adding your name once again to our list of discounting customers.

Conciseness is conditioned on the elimination of unexpressive words and phrases.

Courtesy.—A letter will have more sales power when its purpose is courteously stated; conciseness will have added effectiveness in an atmosphere of courtesy, and the simple "thank you" is one of the credit department's most winning assets. The power of little things is wonderfully demonstrated in the exercise of courtesy; it has a talismanic touch that may build more good will than the most strenuous sales effort. Courtesy in a credit letter, expressed without garishness and extravagant adornment, is the simple human touch that electrifies its purpose.

Summing up the rules of efficient credit correspondence, the total struck is naturalness. Fear, anxiety, and irritation cause an overstrain that will detract from the letter's mission, and unnecessary apologies and platitudes dwarf its penetrating powers.

CHAPTER XV

CLOSING THE ACCOUNT

The Credit Terminal.—The credit transaction is a composite of two fundamental gestures. When barter or money are used for exchange purposes, the transfers are completed in one movement; the vendor receives for his goods the equivalent in other goods or in money. This is not so when credit serves as the exchange medium; the seller of goods receives in the transfer nothing but the credit of the buyer. At some time in the future the credit must be converted into real value, and until then the exchange is incomplete. The credit is a representative only of value, but the time will come when it must be replaced by value itself, and this liquidation is its terminal. The importance of the terminal for every credit may be fully recognized by its nature, since nothing is earned until the receivable into which the goods are converted has reached a terminal and been changed into value.

The balance sheet of a company after a year's operations may reveal a good profit. If receivables are part of the company's assets, the profits shown on the balance sheet are subject to depreciation so long as the receivables are unliquidated. The credit terminal fixes a final destination for profits.

A Good Collection Policy.—It is customary, when estimating losses through uncollectible and frozen receivables, to confine the calculation to those receivables that were actually transferred to the bad-debt column; this is incomplete accounting. The flow from liquidations is direct from receivables to the cash accounts of creditors; when the flow is strong and continuous and allows the creditor to meet his own obligations with ease, capital costs are decreased. The cost of capital is a constant charge in the operations of a business, but one that is not always reckoned with.

Unmatured accounts impose a capital cost that is provided for normally in profit calculations; past-due accounts impose an additional cost upon capital, aside from the dangers that always attend unliquidated receivables. A wise collection policy has two objectives—bringing each credit into its terminal, and doing so on schedule time. When these two objectives are accomplished, the profit figured upon in the loan or in the sale has in reality been made.

A good collection policy has a moral value in addition to its material benefits. The capital integrity and profit-making capacity of the creditor present phases of the material benefits bound up in a good collection policy; the solvency and welfare of debtors are often furthered by making them realize the need of paying their bills promptly. The moral value of a good collection policy is frequently revealed by the respect and patronage that careful debtors will give to those creditors who require them to close their accounts promptly.

Credit managers have been discovered who were indulging in uneconomic practices in the belief that permanent and profitable business could be built by allowing debtors to pay as they pleased. Our financial history is dotted with fatalities that have resulted from the practice of this suicidal policy.

The Credit Account.—When the credit manager accepts a credit it is called a receivable; if it is a written instrument its terminal is stated on its face. The note and the trade acceptance promise that payment will be made at a specified time and place; when the receivable is thus expressed in written form, it is designated as a self-liquidating credit. This does not mean that the written instrument will liquidate automatically; its significance is that the promissor has agreed to pay the obligation at the place and the time designated without further negotiations or demands.

The self-liquidating credit instrument is desirable because of the certainty that it gives to collections, and in that it provides a swifter flow of funds into the cash account. The credit hazard is diminished, and fewer defaults are found to occur to self-liquidating receivables. The open account taxes the resourcefulness of the credit department and is the principal occasion for a strong collection policy. Much time and cost are saved in credit transactions when receivables are reduced to exact collection terms. The written promise, when paid at the time designated, puts the payee in possession of the funds within a brief period. On the other hand, it is very probable that not more than one-fourth of open, undiscounted book accounts are paid within ten days of their maturities, and that an unreasonable portion of the open receivables will drag more than thirty days after they are due before liquidating.

Keeping always in mind that receivables are a capital cost, and that the cost increases when they become past due, it is important that managers adopt a governing rule fixing the number of days' business that should be carried as receivables. This must be, naturally, a flexible rule, governed in each instance by the type of merchandise and terms on which it is sold. If, in illustration, the merchandise is of a nature that sells on terms of sixty days, with a discount of 2 per cent for cash in ten days, the credit manager should strive to have no more than fifty days' business in receivables at any time. Fixing the objective of this limitation involves several computations. In the first place, the discount for cash should be so ardently featured that at least one-third of the accounts will be discounted. Of the remaining receivables a large portion should be collected within a few days of their maturities, and the accounts that still remain should be closed with the least possible delay.

The hazard that is a constant companion of receivables increases with the slowness of their liquidation. When the volume of receivables is disproportionate to sales, the deduction is justified that poor judgment was exercised in selecting the credit risks, or that the department lacked an effective collection policy.

The usual treatment of open accounts is to send the debtor a statement as each account matures, and to record in a tickler the day by which a response should be received. If the statement is not responded to with a check or a satisfactory promise by the tickler date, a letter request for payment is sent and the tickler date advanced. If this request brings no response, the credit manager will proceed to a third step that may be a strong letter or a draft. The department's policy may provide for uniform procedure with successive steps. The third demand should bring from the debtor a check, a promise to pay at some fixed period, or a request for further indulgence, with no definite time fixed for payment. The result of these first steps in the credit department's collection procedure should be a payment of the account or a deferment by agreement, on open account or by negotiable paper.

Should a satisfactory adjustment of the account not be reached, and it remains open despite the credit department's collection letters and without its consent, the receivable lapses automatically into a slow account.

The Slow Account.—The receivable that is late in liquidating is a severe burden on profit, a constant hazard, and a big problem of the credit department. Accounts reach the condition of slowness from various causes. There is one type of slow account that is considered financially safe, but the debtor's payments are constantly made a long time after obligations are due; this type is frequently mentioned as "good but slow." There is a serious question about the appropriateness of this descriptive term. The chronically slow account cannot be fundamentally good, and if the slowness is not corrected a pathological condition is likely to develop that will prove fatal. An observing credit manager once described the dangers of the chronically slow account thus: "Long sickness is sure death." The fact must be recognized that slowness makes an account unprofitable unless an extra mark-up has been provided to compensate for the additional time and risk; simple interest will not compensate for the extra cost or the hazards involved. Sales departments should recognize that the sale of goods at the same prices to prompt-paying buyers and to slow-paying buyers alike gives an unwarranted advantage to the latter class and places a premium on slowness. This discrimination is so little exercised that an undue proportion of receivables drift into the slow class.

There is a type of slow account that results from a sudden and unexpected change in the debtor's condition; the account may have been in the discounting class before slowness attacked it. It will also happen that a new account will not develop as the credit manager anticipated, but, irrespective of the causes, the credit department must be diligent in handling the slow account and strive to bring it with all possible dispatch to its terminal. There are reasons usually for slowness, and generally the reasons are serious enough to test the credit manager's professional skill.

A debtor is slow in his payments, due to the failure of his own receivables to liquidate fast enough to enable him to meet maturing obligations. In another situation, the debtor's merchandise will not sell rapidly enough to make it possible for him to pay his accounts promptly. It is found sometimes that the slow-paying debtor is using his cash for outside purposes, and is neglecting his merchandise creditors. Extreme situations occur where the proceeds from sales are only sufficient to pay the operating expenses of the debtor's business; nothing remains for the merchandise creditors.

It is an axiom in credit practice that slowness is an earmark of failure. The credit manager is placed upon his guard when slowness develops, and to fall asleep on the warning is an undoubted sign of inefficiency.

The slow account may lead the credit manager to review the information on which the risk was originally accepted; while causes are being looked into, he should exert his best possible efforts for a collection of the account or its reduction into some satisfactory form. When the cause of slowness has been discovered, its seriousness will govern the manager's future treatment of the account. In some cases he will be able by counsel and cooperation to show the debtor how his affairs should be handled, and the account eventually advanced to a prompt paying basis.

The Difficult Account.—In this list of accounts are embraced those that resist the credit department's customary collection methods. Demand letters have been accorded no attention, or else the debtor was indefinite and unsatisfactory in his attitude.

Situations will occur where debtors are willing to pay but the condition of their business affairs will not permit of a dependable promise or a definite settlement. Their accounts drag, and fatalities are apt at any time to occur. It may happen that a debtor's stock was destroyed by fire or flood; his abilities to function financially are prostrated and the account passes into the difficult class.

The banking field shows that difficult receivables have caused a large number of suspensions; within the last decade 5,600 banks have failed, involving 7 million depositors and nearly 2 billions of deposits. These fatalities happened, as a rule, because large sums of receivables became difficult and would not liquefy.

To keep difficult accounts at a minimum is one of the highest objectives of good credit management. The account, even in a frozen condition, is still a piece of property, and it should be treated with even more diligence and skill than other receivables. The amount involved may be sufficiently large to justify the credit manager or a member of his staff in going to the debtor and personally seeking a satisfactory adjustment; sometimes a qualified salesman can be drafted and intrusted with the responsibility of interviewing the debtor, explaining the seriousness of his delay, and effecting a satisfactory settlement.

At the request of their subscribers, credit interchange bureaus in several cities will have the affairs of a debtor investigated by an expert, when a ledger clearance reveals that he is owing a certain amount of which one-half or more is past due.

The sequences of difficult accounts are not uniform. A debtor may be able to right his financial affairs and satisfy his creditors without forcing them to take any unpleasant action. On the other hand, the difficult situation may be the result of an organic defect in the debtor's business. Poor merchandising ability or unusual conditions may have caused the debtor's obligations to congeal, or the situation may be the result of an unexpected or unpreventable disaster.

It is usual in credit department technic, when the difficult account is not important enough to justify unusual effort or expense and after the customary collection methods have failed, that the account will be placed with an attorney or some organization for collection.

Where the circumstances surrounding the account suggest the credit department's special attention, then various alternative procedures may present themselves. An investigation of the debtor's affairs may reveal a condition that offers no hope of recovery. It may be wise to call a meeting of the interested creditors for a cooperative effort to bring about a liquidation of the debtor's business, and to prorate the proceeds without incurring the delay or the expense of bankruptcy proceedings. The investigation may reveal a situation where good counsel and patience will remedy the debtor's trouble. Again, the creditors should act in concert and arrange among themselves to help the debtor with advice and supervision; committees of creditors are sometimes selected for this supervisory purpose. Under such an arrangement the debtor's affairs are in charge of his creditors until the business is financially improved. A difficult condition may be discovered where the debtor has not been governed by ethical ideas; his business has fallen into bad straits and he refuses to take the advice of his creditors. There is no alternative in this situation but for the creditors to invoke the bankruptcy law.

Sometimes a debtor embarrassed by long past due obligations can obtain financial assistance and be permitted to continue the business if the obligations pressing against it can be adjusted; to accomplish this, a composition may be the only feasible plan. The creditors may deem it wise to accept a portion of their claims rather than hazard the possibility of losing all or a larger part. In a creditors' conference over the affairs of a hard-pressed debtor, the conclusion may be to recommend a compromise settlement. It is a wise rule for the credit department never to entertain a voluntary composition offer until the debtor's affairs have been carefully and thoroughly examined.

Attorneys and Collection Organizations.—The receivable as a piece of property should not be depreciated by ineffective treatment. When it is placed with someone else for collection, the credit manager should know beyond doubt that the trust has been reposed deservedly.

Years ago credit managers used attorneys whom they knew personally or who were highly recommended. Receivables multiplied so rapidly that collection agencies were organized and were used for adjusting slow accounts; some of them did not warrant the confidence of credit departments and it became a wise procedure for credit managers to measure the dependability of a collection agency with the same thoroughness that a credit risk was measured.

The National Association of Credit Men refused at first to recognize collections as one of its legitimate services. This attitude gradually gave way to the pressing need for a collection service that would be supervised and controlled by credit managers, and local associations of credit men in many cities have set up departments for collections. These departments offer the service of a direct demand letter at a nominal charge or as a free service. The debtor is likely to be impressed with the organization back of the demand, and will make efforts to settle the account when the direct demand of his creditor had failed to arouse him.

The services of traveling adjusters are offered by some of the credit men's collection departments and several of the larger collection agencies. The traveling adjuster will cover a certain route and call on the delinquent debtors; this is a very practical collection idea which should gradually broaden in adoption and in results.

Finally, should the debtor not respond to the direct demand or efforts of the collection organization, the account will be sent to an attorney for such action as the debtor may force or his condition may suggest. The attorney in many cases will be able to collect from the debtor upon his direct demand, or he may arrange with the debtor to pay in a manner that will save further action. If the attorney is unable to effect a settlement and the creditor authorizes the action, suit will be instituted and judgment taken unless in this legal stage the debtor will satisfy the claim.

In closing accounts, when the credit department's resources have been exhausted and all of the available aids have been utilized, whatever receivables remain unsatisfied become a part of the bad-debt losses incidental to credit transactions.

CHAPTER XVI

THE CREDIT MANAGER AND BUSINESS LAW

Business Law and Credits.—The credit transaction is a contract, and the debtor's promise and its acceptance by the creditor constitute a meeting of minds that make the contract, either expressed in writing or implied.

The two parties to the contract, creditor and debtor, enjoy rights and suffer disabilities founded on business law. Conditions will arise after the acceptance of a risk and before the account has been closed that are not within the powers of the credit department to control and the law has provided redresses and remedies that will sustain the rights and obligations involved. The credit manager has greater efficiency when the assistance given by law is understood. Training in business law increases greatly the effectiveness of credit management, as without it a credit manager may sacrifice rights that the law has placed as buttresses to the credit contract.

It is not wise nor proper for the credit manager to act as his own lawyer. The laws relating to credit contracts have been variously interpreted, and the legal practitioner will often be necessary to unravel tangled situations or to defend a creditor's rights. But a knowledge that certain legal rights and obligations do exist will help the credit manager to avoid pitfalls and to protect existing credit contracts.

The Statute of Frauds.—This is a title given to certain laws requiring written evidence in agreements; based on a statute enacted in 1676 during the reign of Charles II, they are substantially uniform throughout the United States.

A credit manager may accept the promise of a third party to see that payment is made in the event of the buyer's default; if not in writing the promise could not be enforced.

The credit department may be induced to accept a credit upon the assurance of a third party that the buyer is solvent and dependable; in the event that the buyer defaulted the third party could not be made liable for the debt unless the assurance was in writing.

A credit transaction may be entered into with a minor, and the contract could not therefore be enforced. The minor after coming of age promises to pay the debt, but unless the promise was made in writing, it is legally valueless.

There are other credit situations affected by the statute of frauds, and the credit manager should acquire a general knowledge, at least, of the extent to which this old statute has been rewritten into the laws of the various states.

Sales and Cancellations.—The agreement to sell and to purchase is a contract. It is not enforceable in most of the states if the order exceeds a sum fixed by statute, unless the contract is in writing and signed by the buyer or his authorized agent. This rule is qualified by the provisions that a partial payment on the purchase, or a partial delivery of the goods accepted by the buyer, makes the contract binding.

These provisions of law determine the seller's rights if orders should be cancelled by the buyers after the credits have been accepted. If the order was in writing and signed as required by statute the cancellation is not effective; the buyer can be sued for the account.

The buyer must be of legal age to make an enforceable purchase contract. Minors can repudiate their contracts; if the goods were received and disposed of the minor cannot be held liable for the account. The credit manager should exercise caution to know that the applicant can make a binding contract.

The married woman still suffers limitations in some jurisdictions. The credit manager should be sure when considering the credit of a married woman .that she possesses the legal power to make a credit contract. Capacity to contract is necessary to the enforcement of an agreement and the collection of the consideration for a sale.

The Commissioners on Uniform State Laws drafted a model Sales Act, which has been adopted in twenty-nine states. The language and purpose of this model statute has been highly commended; the passing of title from the seller to the buyer is the moot question in contests over the legality of sales, and this question has been greatly clarified by the terms of the statute. The right to stop goods in transit, which is frequently valuable in credit transactions, has been provided for by the statute under certain conditions.

A broad analysis of the Uniform Sales Act cannot be comprised in this general treatment of the business laws that credit managers should know. Its terms and the interpretation given to the statute is important knowledge for the credit manager; a credit may be intelligently measured, but if no agreement to purchase was made an enforceable contract does not exist.

The Landlord's Lien.—A credit contract may be seriously affected in its enforceability by the superior position accorded landlords in many of the states. The credit exchange, without conditions, serves to give the buyer possession and ownership of the goods purchased, and they may be used to satisfy the landlord's lien, though they may have not been paid for.

The superior position thus given to landlords places a disability upon general creditors that they cannot avoid. The landlord's lien is a hidden reef for which credit managers must constantly watch.

Some state statutes allow a superior position to landlords not only for accrued rentals, but for all or part of the period for which the lease was to run. Cases are not infrequent where the landlord's lien absorbed all of the tenant's goods and nothing remained to satisfy the merchandise debts. In bankruptcy administrations landlord's claims for rentals are allowed according to the laws of the state where the bankrupts reside; the landlord's lien must be regarded as a real menace to creditor's claims in those states. It is the usual practice that the landlord's lien cannot be imposed upon goods in possession of the tenant under conditional sales agreement, and to which he had no legal title. There are exceptions to this law, however.

This subject is of grave importance to credit managers; the laws governing the landlord's lien of the states where they are doing business should be fully known. Of all the dangers to credit none is quite so real as the superior position given by law to one creditor above another; a knowledge of landlords' lien laws serves as a chart for the credit manager so that the chances taken are known in advance.

Exemptions.—There was a deeply ingrained belief at the beginning of our national career that the heads of families should be afforded some protection against the entire loss of their possessions by financial misfortunes, and exemptions were allowed of goods and money in varying amounts and kinds by enactments in the various states. These exemptions were regarded with the greatest jealousy by the people of many states, particularly in the agricultural sections.

The bankruptcy law, when enacted in 1898, was forced to recognize this sentiment for exemptions; the sixth section of the bankruptcy statute declares that its provisions shall not affect the exemptions to which bankrupts are entitled.

The original and underlying purpose for granting exemptions has been removed by our commercial and financial achievements; there still remains, however, a section of the people who are unwilling to give up the protection, and are sufficiently strong numerically to prevent the repeal or modification of exemption allowances.

At the present time exemption laws exist in nearly all of the states. Delaware, Maryland, Pennsylvania, Rhode Island, and the District of Columbia are the only jurisdictions where exemption laws are not in force. In the industrial states exemption allowances are, as a rule, extremely nominal, but in a number of the agricultural states exemption allowances are unreasonable and do not accord with our present economic conditions. A waiver of exemptions, if in writing, is permitted by the laws of some of the states; in other states a waiver is not permitted in any form.

The credit manager confronts a visible danger when credits are accepted in states where exemptions are allowed of unreasonable amounts; it is good credit management to know thoroughly the exemption laws of the states where sales are made, and where exemptions can be waived by written agreement.

The Negotiable Instruments Law.—A model act for the regulation of negotiable instruments has become a law in every state, and also in Alaska, District of Columbia, Hawaii, and the Philippine Islands. Before this act was adopted the movement of negotiable paper was interfered with by the laws and judicial decisions of the various states. The uniform statute has been differently interpreted in some states but as a whole the act furnishes a near approach to unanimity.

It is important to know well provisions of the Negotiable Instruments Act, because credits are often expressed in written form. At times it is desirable to state in the written instrument that the costs of collection will be paid by the maker in the event of his default and the forcing of an attorney's collection. The uniform act does not declare the instrument in this form to be non-negotiable; the consensus of construction is that this provision may in some states affect the negotiability of an instrument, but that its validity will not be impaired.

Discrepancies are frequent in the drawing of written instruments; the figures and the words may not agree and the written and the printed portions may be at variance. The uniform act provides that the written portion shall control the instrument in both of these situations.

The Negotiable Instruments Act does not approach the chief problems of the credit manager as other business laws do, but he should know its provisions and through the knowledge be equipped for emergencies.

The Liability of Banks for the Collection of Checks.—The credit manager is often perplexed over the remedy available when a correspondent of his depository bank collects a check and because of insolvency or other conditions fails to remit the proceeds.

Two rules have developed in this perplexing field, known as the Massachusetts rule and the New York rule. The former relieves the forwarding bank of liability when its correspondent had been carefully selected, and no special agreement had been made for collecting the check. The New York rule holds the forwarding bank liable to its depositor for the proceeds of the collected check when its correspondent defaults. The credit department should know these rules and the jurisdictions where they apply.

Unsafe Collection Schemes.—Forcing difficult debtors to pay has been the objective of a number of trick collection schemes and credit managers have been induced to buy such services because they were represented as being able to frighten debtors into paying.

The law is jealous alike of prompt paying debtors and poor paying debtors by giving them protection against schemes that threaten to defame character for the purpose of forcing payments; the credit department must not use any collection schemes that the law might regard as libelous and actionable. The credit manager should never resort to threats that he cannot safely or conscientiously carry out.

Chattel Mortgages and Conditional Sales.—The possession of property is not always an assurance of its ownership. The property may be encumbered by a chattle mortgage, or may be held under a conditional sales agreement.

The uninformed may be deceived by the possession; if the new creditor is without remedy against goods to which the buyer had no title when the purchase was made. The buyer is under no compulsion to divulge the nature of his possession; therefore credit managers must explore all sources of information that will divulge the existence of a chattel mortgage or a conditional sales agreement. In most of the states these must be recorded to be binding; such records should be discovered by the mercantile agencies or some specialized reporting service.

Credit Protection Statutes.—Statutes have been specifically enacted to protect credit transactions against conditions and practices that the individual cannot control or correct. The theory has been traditional in credit circles that laws should not be sought for the regulation of conditions that were within the manager's powers to control; seeking a weapon, not a crutch, has been the governing principle of organized credit managers when they invoke the assistance of legislatures. Circumstances will arise where individual power cannot attain the necessary protection, and only for these have credit managers sought to obtain laws that will supplement their efforts to protect the credit contract.

Bulk Sales Laws.—The purchaser on credit terms secures title to goods bought when no deceptions have been practiced and the sale was unconditional. Credit serves to transfer title with effectiveness equal to barter and to cash; though the goods are not paid for they belong to the debtor and he can do with them anything that the law does not forbid.

It was formerly a favorite scheme of debtors, for fraudulent purposes, to sell their goods in bulk for cash and to leave creditors with no recourse; creditors of the vendor had no recourse against the vendee, and only a civil action for the debt. To correct this trouble by regulating through statutes the sales of goods in bulk was one of the first policies of the National Association of Credit Men, and no protection of greater value in the prevention of fraud has been rendered to commercial credit.

The first bulk sales law was obtained in Louisiana in 1896; there is now a regulatory law in every state and territory of the United States, and the legislation has been adopted in Canada under the sponsorship of the Canadian Credit Men's Trust Association Ltd. These laws provide such a drastic change from usual legal practice that at first they were viewed most critically by the courts. Several of the early state statutes were declared unconstitutional, which forced the enactment of new laws. After two efforts, a proper law for the regulation of sales in bulk could not be obtained in Ohio until the state constitution had been amended.

The bulk sales laws do not prevent a merchant from selling his stock of goods and his fixtures; they do require that notice of intention to sell shall be disclosed to his creditors so that ample time may be allowed them to protect their interests. The bulk sales statutes are uniform in principle though not in their provisions.

There is one type of statute prevailing in New York and thirty-two other states. These statutes provide that sales of stocks in bulk, and fixtures, shall be void against the creditors of the seller unless five days before the sale a full and detailed inventory is taken, showing the quantities and the cost prices of the articles to be sold. The statutes further provide that the purchaser must demand and receive of the seller a written list of his creditors, their addresses, and the amounts owing to each. Five days before taking possession the purchaser must notify each creditor as listed by the seller, of the price, terms, and conditions of the sale.

Another type of bulk sales legislation prevails in Pennsylvania and eight other states; their provisions are stronger in the protection they give to creditors than in the New York statute. The Pennsylvania statute requires a notice of ten days to be furnished creditors of the seller; the non-complying buyer may be held liable to the creditors as a receiver; a sale not complying with the statute is fraudulent and void; the buyer is required to see that the proceeds of the sale are distributed among the creditors of the seller. Any seller who knowingly and wilfully furnishes a false or untrue statement to the purchaser is guilty of a misdemeanor.

The bulk sales law of Montana while following the general pattern of the Pennslyvania statute does not require a notice of the proposed sale to be furnished creditors of the seller. The statutes of California and three other states provide, in place of a written notice to creditors, that a notice of the proposed sale shall be recorded at least fourteen days before the sale is consummated.

The sales of executors, administrators, receivers, trustees in bankruptcy, and assignees for the benefit of creditors, are not included in the terms of these statutes.

Only the framework of these highly protective statutes can be presented in this chapter; credit managers should acquaint themselves with their complete provisions and judicial interpretations.

Fictitious Name Laws.—The purpose of these protective laws is to require the disclosure of the real names of persons conducting a partnership business; when goods were bought and charged to a concern operating under an assumed name, as the "Bee Hive," it was easy for owners to evade responsibility for the purchase by disclaiming any ownership in the enterprise. To remedy this, fictitious name laws have been enacted in nearly all of the states. In general terms the statutes require any person transacting business under a fictitious name to file, in the office of the county clerk or the town clerk, a certificate setting forth the name under which the business will be conducted, and the true name of the person or persons conducting the business, with their post-office addresses. The statutes provide, as a rule, a fine or imprisonment for violations. By some of the statutes violators are deprived of their legal status; they have no powers to institute suit on contracts; they cannot claim exemptions in case of insolvency. These statutes afford considerable protection to credit contracts, and should be known thoroughly by credit managers.

Bad Check Laws.—A majority of the states have enacted bad check laws but their provisions are not uniform. The laws provide generally that the drawing of a check when there is knowledge of insufficient funds and credit behind it is a crime. The laws of twenty-one states make the offense a misdemeanor; in five states the laws make it larceny; the laws of six states merely declare that the offense is punishable when property has been obtained by the bad check. The majority of the bad check laws provide that intent to defraud is necessary to constitute a punishable offense.

There is an interesting feature in most of the bad check laws. The drawer of the check, after receiving notice of its dishonor, may purge himself of offense by making the check good within a fixed number of days; the margin of time allowed is from twenty-four hours to thirty days, a majority of the laws allowing either five or ten days.

Conclusion.—Other business laws than those mentioned in this chapter are of serious concern to credit managers. The National Association of Credit Men publishes annually a *Manual of Commercial Laws*, compiled under the direct care of the association's counsel. The manual presents a useful digest and a practical synopsis of the laws vitally affecting the credit department's operations.

CHAPTER XVII

COMMERCIAL FAILURES—THEIR CAUSES AND PREVENTION

Business Mortality.—The high mortality in business ventures vividly portrays the absence in too large a measure of the qualities needed for safety and success. As a rule, the business venturer will not understand the extent of skill required to handle capital converted into goods in a manner that will keep the capital intact and add a little in the turnover. The soliloquy usually is: What can be easier than to sell goods at a little more than their cost, and sell enough of them to make the business pay well?

A short time only is necessary to reveal the hidden difficulties; it is quite a task to buy and sell merchandise so as to provide a sufficient margin of profit to cover the costs of operating the business, or converting the merchandise into receivables that will liquidate promptly. The skill demanded for conducting a business profitably is not realized by many venturers into the commercial field until their investments begin to dwindle; the more prudent of these will retire before their capitals are entirely swept away, but others will persist with the hope of recouping their losses, or without a true realization of their dangers, until the collapse finally comes.

In either event the effort has failed. In one instance losses fell alone on the venturers; in the second instance creditors were forced also to lose. A true estimate of the cost imposed upon business by failures must include both credit and capital losses. In illustration: a business concern with a capital investment of $50,000 fails; the liabilities amount to $100,000, and creditors receive in final settlement one-half of their claims. In this case the credit loss and the capital loss are the same and the entire financial loss is $100,000.

The capital losses brought about by business mortality amount in the aggregate to several hundred millions of dollars each year. The high business mortality and the nature of its occurrence lead to the reflection that just as candidates for the important professions must demonstrate their fitness by examination before they are permitted to practice, so the right to carry on a business should be granted only on proof of fitness. The democracy and competitive spirit of business are not congenial to this theory; the business highway must be left free to all who wish to make the venture, but the fatalities convincingly show that only as the markings of the business highway are pointed out and the unfitted discouraged from making the attempt will the mortality rate be lowered.

Credit Failures.—The unsuccessful business that becomes insolvent and occasions losses to its creditors is a credit failure. This mortality cannot be entirely avoided in credit transactions; the ease with which a business can be brought to a standstill when its control is not skillful shows how the failure fatality is a potential hazard of credit commerce. The totals of our credit failures reveal a figure so large that we can assume that we are a considerable distance from a proper mortality rate. The cost of failure is a burden on distribution and a reflection on the wisdom of our credit and sales policies.

During the first three months of 1930 R. G. Dun & Co. recorded 7,368 failures. In the same period of 1929 the failures recorded by this agency numbered 6,487. The increase of 12 per cent was accounted for, undoubtedly, by the larger problem thrust upon merchandising by the business depression. The number of unsuccessful ventures involving capital losses only, also rose in magnitude during the first quarter of 1930. The assets of the failed concerns in the first quarter of 1930 amounted to $70,903,000 and the liabilities were $169,357,000. These figures show an increase of $9,467,000 in assets and $45,089,000 in liabilities above the statistics of 1929.

Projecting these figures for three months over an entire year, it is safe to assume that at least 2,000 business concerns will fail each month; that their liabilities will average at least $25,000; that the credit losses will amount to $500,000,000 in the year, and the capital losses an equally large sum. An analysis of the failure statistics reveals that a majority of the unfortunate enterprises were operating on a small capital—$5,000 or less; the analysis also clearly shows that a large percentage of the failures were preventable.

The high failure loss figures throw a tremendous onus on credit departments. The problem can be solved only by a clearer marking of the business highway; by a better understanding of why business ventures fail; by the heading off of fatalities where they threaten.

The Causes of Failures.—It is customary in clinics of business mortality to place almost the entire responsibility at the doors of the unsuccessful debtors. Inadequate capital, incompetence, extravagance, injudicious credit, and other intrinsic and extrinsic defects, are usually assigned for credit failures.

These causes, as a rule, do not reach into the heart of the trouble; the enterprise with small capital, when inefficiently managed, will come to an end rapidly, but, as a matter of fact, a larger capital would merely defer the disaster if its management was inefficient. The unsuccessful debtor may be charged with incompetence when in reality it was a case of not having been shown the rules. Extravagance may be imputed as the cause of a failure, when something more fundamental in the debtor was the real reason.

To neglect the creditor in an analysis of failures is unjust to the survey; in almost every failure subjected to unprejudiced scrutiny there would be found a mingling of faults. The debtor had not observed the rules of business success; the creditor had failed to observe the rules of precaution and prudence.

The Debtor's Faults.—To what extent the debtor is responsible for his insolvent condition is the first question for review in a study of failure causes. The undertaking in any field that is not motivated by a management adapted to the project has slender chances for success. To merchandise successfully calls for a management congenial to the problems of buying, producing, and distributing goods. It must appeal to the instinctive qualities of the venturer, or the attempt is likely to fall flat.

Lack of adaptation is one of the major causes for business failures assignable to debtors. The unadapted merchandiser can be oversold by the persevering salesman; he can lose sight of the safe ratio of cash to current debts, and he is inattentive to customers' needs.

There is difficulty in discovering through an interview or from an initial investigation this particular defect in a business candidate, but the absence of adaptation will soon manifest itself in some distress symptom of the business. Payments may become slow because of reduced working capital, overstocking, or from too large a sum tied up in stagnant receivables. The lack of adaptation is an incurable defect, and the business with this defect will not, as a rule, endure.

The second major fault of debtors, and responsible for the largest share of mortality, is the *lack of training*.

In the analysis of failure causes, basic faults are almost always confused by the various ways in which they are manifested. The driving of an automobile, by way of illustration, is undertaken by some one who has never before attempted it, who has no knowledge of the gears, who is ignorant of the rules of the highway. When the inevitable smash happens, was it incompetence or was it crass ignorance that caused it? The same driver with the necessary training can guide the machine safely and minimize accident hazards.

The business machine has its gear shifts and controls; it possesses no automatic qualities; it must have fuel, and it needs a skillful hand to guide it. Picture a driver of the business machine who does not know how to handle the gears, who has no idea of control, who is ignorant of the highway rules. It is imaginable that such a driver in remote instances may get through traffic safely, but the chances preponderate that a fatality will happen—one that will destroy his machine and damage others. Was it incompetence? Was it the size of the machine that the unfortunate owner was driving? Was the accident caused by anything less than that the driver had not been trained?

The fuel of a business is its working capital. When the fuel becomes impaired the machine slows down; when the fuel is exhausted the machine stops. The working capital is the margin between current assets and current liabilities; to keep the business at a proper speed this margin must be sufficient to absorb depreciations, provide for emergencies, and enable it to liquidate obligations. For every dollar of current payables a business should have at least two dollars of earning assets. Working capital, being equal to current payables, provides a cushion for depreciation in earning assets before credit obligations are placed in danger.

The gears of the business machine must be properly meshed so as to provide for ease and safety of movement. The driver who does not know how to keep the business machine in trim is a peril to himself and to his creditors. The siren song of salesmen may lead to a crowding of the merchandise account with unsalable or slow-moving goods; as an earning asset merchandise cannot stand still without losing value. As merchandise ages its sale value declines rapidly. Failures have happened where goods a decade old were discovered in the debtor's stock. They had perhaps been inventoried from year to year, when as a matter of fact they were of less value than junk.

Business ventures have been wrecked by extensive duplication of standard goods in attractive containers, marketed under high-sounding brands. The untrained owner fails to see the danger to his working capital of increasing the liabilities without doubling that increase in the earning assets.

The traction of a business machine is a conversion of merchandise and receivables into the cash with which to pay operating costs and credit obligations as they accrue.

The speed register of a business machine is its accountancy system. There is no way to tell whether the machine is going forward, is marking time, or is moving backward without this register. Consider the dangers of an owner who cannot tell with approximate certainty whether the fuel of his business is becoming exhausted and whether its gears are properly meshed. Only accountancy records will reveal the unsafe narrowing of working capital and the increase of liabilities without a proportionate increase in earning assets. Records will show why this dangerous impairment of working capital is occurring, whether because of slow-moving merchandise, inadequate profits, excessive costs, frozen receivables, or too large an investment in plant, fixtures, and equipment. Innumerable failures occur where no accounting records were kept.

Of failures chargeable to unfitness by lack of training, a large proportion are preventable. A charge of incompetence can rightfully be resented by the insolvent debtor who could have succeeded had he been told how; when placing the onus solely on insolvent debtors an injustice occurs. Where does the greater responsibility rest—upon the debtor who could have survived had he been properly coached or the creditor who could have coached him but was more immersed in selling than in saving?

The third major cause of failures chargeable to debtors is the *lack of character*. When goods are bought or loans sought with no intention of paying the debt, character is lacking, but only a small proportion of business failures is chargeable to intentional fraud or to credit banditry. Instances are much more numerous where defective character manifests itself in other ways. The chronic habit of taking unearned discounts, of making unjust claims, of cancelling purchase contracts, are earmarks of character defects. Window-dressing of financial statements for the purpose of bolstering a declining credit, or to obtain goods, is a character defect pointing to failure. Converting assets into cash and placing the cash beyond the reach of creditors is a resort of some debtors when in financial extremities.

The character defect is serious when nothing more than a promise is accepted for value. Repairing a defective character is more difficult than to restrain its activity, and unless repaired or genuinely restrained the character defect is fatal to credit. In very nearly all instances the character defect will appear somewhere on the surface, and the alert credit manager can detect the earmarks of a wily, devious, or crooked business operator.

The Creditor's Faults.—If creditors played the business game with due regard for one another and for debtors, failures would decline more than one-half. Unnecessary costs of distribution are accounted for by the folly of believing that sales volume and profits synchronize.

Recently in New Haven a number of bankruptcies were submitted to judicial and academic examination. This clinic decided that 75 per cent of the bankruptcies were needless. In other words, the clinic imputed to lax creditor policies the larger share of these failures. "Killing debtors with credit kindness" was the specific charge of the clinic. Of the bankruptcies examined, five of the debtors had previously failed, and there had been no effort, apparently, to discover whether these debtors had profited by the experience.

Rapacious sales policies rather than credit kindness would better describe the creditors' faults; cases have occurred where goods were furnished to debtors of known doubtful standing and paying ability. A sales department in one instance insisted upon the shipment of an order, with the explanation that a 50-per-cent payment was better than to have the goods in stock. Crowding merchants with goods beyond their credit capacity and making sales paramount to everything else have brought about many failures. Indulging a debtor when pressure is proper and pressing a debtor when indulgence is proper are causes of commercial mortality chargeable to creditors.

The relation of good credit control to business success and safety is not well enough recognized by the creditor who holds the whip handle in credit transactions. Chances are taken for the sake of making sales that will hasten the end of the unadapted buyer, will wreck the untrained venturer before he can learn how to control the business machine and the rules of the business highway.

Preventing Commercial Failures.—The responsibility for preventing failures is shared by all departments of a business. The well-produced goods yield no profit if the receivables into which they are converted fail to liquidate. The well-sold goods represent a waste of time and value if money is not finally obtained for them.

Scientific distribution demands the sincere and deep interest of creditors in the ability and safety of the outlets through which their goods are marketed. Good sense, humanity, and profit-making urge a coordination of sales and credit policies for the prevention of failures. The unfitted must not be smothered with goods, and the qualified must not be hampered by the competition of distress merchandise.

The fact is not recognized, as a rule, that consumers can absorb only a certain amount of goods. Setting up new retail outlets will not increase the total volume of business in a community. Good sales and good credit policies should join and strive to protect the qualified outlets, and not increase their problems by making possible unintelligent competition. The credit department should be the scout in this cooperative work. If the credit department is convinced that an applicant is unfitted to merchandise, its judgment should be respected by the sales department. If earmarks of failure are detected in a debtor by the credit department, sales pressure should be lifted until the signs are probed. If a concern is found operating without proper accountancy records, the credit manager's decision to suspend the credit until the fault is remedied should be supported by the sales department.

In conclusion, all the facts discovered by a careful survey of business mortality clearly indicate that the business highway is congested with unfitted venturers. Skillful credit work and wise salesmanship can direct the traffic so that the unfitted will be removed and the deserving trained with a reduction, in consequence, of more than one-half of the commercial mortality.

CHAPTER XVIII

CREDITS AND THE BANKRUPTCY LAW

The Significance and Purpose of Bankruptcy.—Bankruptcy pictures a trader in default on his credit obligations; broken by the weight of his debts. The derivation of the word "bankrupt" has been credited to the Latin phrase, "bancus ruptus" (broken bench). The hazards surrounding business conducted on a credit basis began with the first transaction. Through every evolution in trading contacts defaults have occurred, and merchants, unable to pay their debts, have become bankrupts.

Legally, bankruptcy is the recourse available to a broken debtor and to his creditors when obligations cannot be met. The genius of commercial jurisprudence through the classical period, and the dawn of modern business strongly favored creditors. Though Justinian's code of Roman law recognized the advantage of relieving bankrupt debtors when all they possessed had been voluntarily surrendered to their creditors, yet the creditor's rights were held to be paramount. Punishment faced the debtor who had been remiss and had failed to safeguard his creditor's interests by reasonable precautions.

This legal aspect of the credit obligation was adopted into the Code Napoleon, and distinguishes today the bankruptcy jurisprudence of France and other continental countries. The bankrupt must make a clean breast of his affairs under the Civil Code. He must show a freedom from neglectful practices, from any failure to protect his obligations by the observance of reasonable rules, from any deceit or fraud; severe punishment threatens the neglectful or the devious debtor.

The English colonists of our Atlantic seaboard had been concerned, more or less, with trading and farming before they left the Mother Country, and were familiar, no doubt, with the

English bankruptcy system that had been in operation since 1542. In its original form the English Bankruptcy system provided no relief for debtors and was severe on dishonesty. Later the law was modified and relief was granted to debtors under certain prescribed conditions.

Bankruptcy in the United States.—Traditions had instilled a great respect for the creditor's position, which attitude was not tempered by the fact that in a transaction where value is exchanged for a promise the contracting parties assume a mutual hazard. Imprisonment for debt was a conception that persisted through the youth of our republic, but this recourse of creditors was unproductive and the sentiment toward bankruptcy practice changed with the changing concepts that fashioned many of our social and political ideas.

The pioneers of our nation contended against dire hazards; chances and adventures were their constant companions, and around their free spirits the shackles of a strict commercial code could not be tightly drawn. If democracy meant anything it meant equality; debtors and creditors both enjoyed rights and suffered disabilities.

Bankruptcy Legislation in the United States.—The Philadelphia Convention of 1787 recognized the need of establishing a uniform procedure for the relief of bankrupt debtors, and the Constitution vested in Congress the right to enact a Uniform Bankruptcy Law. (Article 1, Sec. 8.)

As political theories crystallized, the right of Congress to enact a Uniform Bankruptcy Law was drawn into debate. A federal bankruptcy law was regarded by militant democracy as a direct invasion of the rights of the states to deal exclusively with the credit obligations contracted within their respective borders. In debating this question no thought, apparently, was directed to the constructive purposes of a uniform bankruptcy law; subordinating the economic need to the political issue has prevented the United States from enjoying the complete stabilizing powers of a truly scientific bankruptcy law. For generations the idea persisted that a federal bankruptcy law was only intended to clean up the bad credit mess that usually followed a panic. Having performed this scavenger work, the law was deemed no longer needed.

Under its constitutionally vested right, Congress enacted a bankruptcy law in 1800, which existed for three years. Again in 1841, following the insolvencies brought about by the severe panic of 1837, Congress enacted a bankruptcy law which was repealed in 1843.

In the time between the first and second bankruptcy laws, the Supreme Court of the United States, in a strongly contested case, (Sturgis vs. Crowninshield) decided that the states have power to establish insolvency laws; provided such laws do not violate the constitutional right of contract, and do not conflict with any system of bankruptcy established by Congress. This decision increased the difficulties of obtaining a federal bankruptcy law that was well conceived in its treatment of insolvent debtors, was fair, and susceptible of economic administration.

A third bankruptcy law was enacted by Congress in 1867, which law was permitted to remain until 1878. When the repeal of the third bankruptcy law took place, the insolvency laws of the various states were immediately revived, and a confused and disorderly treatment of debts persisted for twenty years. Such inconsistent, antagonistic, fair and unfair insolvency laws as were in operation through these two decades, almost defy the imagination. The older and industrial states sought, as a rule, to be fair and impartial in their insolvency laws. The frontier and agricultural states favored debtors and preferences were permitted that placed distant creditors at a serious disadvantage.

Despite the native ingenuity and initiative of its leaders, commerce could make no great headway; the potent element, credit, was held in a vise by this situation. When credit facilities were unorganized; when no technic controlled the credit flow; when debtors were endeavoring to pay the least and creditors were striving among themselves to get the most, it was but natural that ruptures should occur and that overstrained credit should result in disasterous panics.

For several years intensive efforts were made by individuals dissatisfied with conditions, to convince Congress that another bankruptcy law was needed to clear up the congestion of 1893; Congress debated the subject, old political theories were revived, and action evaporated into words. Opposition to a federal bankruptcy law arose from some large distributors who used staffs of traveling and local attorneys to act quickly and secure the debts owing them when debtors were discovered in a weak condition; this strategy resulted usually in depriving smaller creditors of fair chances for recoveries.

The Bankruptcy Act of 1898.—The National Association of Credit Men saw clearly that the first step toward credit stability was to place creditors on an equality, and a federal insolvency law was hailed by the organization as its first aggressive opportunity. This objective was held to steadfastly, and in 1898 a fourth bankruptcy law was enacted.

The Congress of that year was influenced by populistic sentiment, and the law as passed suffered from its birth some unnecessary and prejudicial disabilities; but the law has remained upon the nation's statute books despite a continuing political and private opposition. Organized credit management has continued to recognize the need of the law, and has resisted every effort for its repeal.

A serious disadvantage has been suffered by the law through the difficulties of obtaining amendments consonant with the changing needs of credit commerce, but major amendments were finally obtained through three well-organized movements. The last amendments conceded by Congress, in 1926, were remedial of some glaring defects and provided some pressing administrative needs, though they did not rectify certain original defects.

Who May Become Bankrupts.—The Act of 1898 provides that any person, except a municipal, railroad, insurance, or banking corporation may voluntarily seek the law's benefits. Any natural person, except a wage earner or a person engaged in farming, any unincorporated company, and any business or commercial corporation, except a railroad, municipal, insurance or banking corporation, owing debts of $1,000 or more, may be adjudged an involuntary bankrupt. The prejudices of the enacting Congress in favor of wage earners and farmers were revealed in the permission given these classes to invoke the law by voluntary action, but depriving their creditors of involuntary action.

A fundamental mistake was not to confine the law's operations to commercial debtors. Non-commercial bankrupts largely outnumber the commercial bankrupts and badly clutter the law's administration. The bankruptcies of 1930 will undoubtedly exceed 50,000; not one-half of this number will result from commercial credits.

Initiating Proceedings in Bankruptcy.—The machinery of the law is set in motion by the filing of a voluntary petition by the insolvent debtor, or an involuntary petition by three creditors of the debtor having claims amounting to $500 or more. In the event that there are less than twelve creditors, a single creditor having a claim of $500 or more may file an involuntary petition.

Acts of Bankruptcy.—Petitioning creditors must show that the debtor has committed one, at least, of the six acts of bankruptcy. These acts are:

1. Fraudulent conveyances, transfers, concealments, or removals.
2. Preferences. These obtain when a debtor transfers any portion of his property to one or more of his creditors, with intent to prefer such creditors over his other creditors. The preference must be made intentionally, with the acquiescence of the creditor, and the debtor must have been insolvent.
3. Preferences through legal proceedings. A debtor who suffers or permits, while insolvent, any creditor to obtain a lien upon his property through legal proceedings, and who does not at least five days before the property is sold or disposed of under such lien, have it vacated or discharged, has committed an act of bankruptcy.
4. Suffering or permitting, while insolvent, anyone to obtain through legal proceedings, any judgment, attachment, or other lien, and failing to discharge the same within thirty days after such lien was obtained.

5. Assignments for the benefit of creditors. The making of a general assignment for the benefit of creditors is an act of bankruptcy. The appointment of a receiver or trustee, is an act of bankruptcy if it occurs during insolvency.
6. Admission in writing of inability to pay one's debts, and willingness to be adjudged a bankrupt on that ground.

The debtor is permitted to contest the allegations contained in a petition and may file an answer that he has not committed the act or acts of bankruptcy alleged, or that he is not indebted to the petitioning creditors or any one of them. The issue thus raised is tried in the United States District Court, in the district in which the petition was filed. The trial of the issue results in an order adjudging the debtor to be a bankrupt, or an order dismissing the petition.

Filing of schedules, after adjudication on voluntary or involuntary petition, is required of the bankrupt. These schedules are intended to set forth the bankrupt's assets and liabilities.

The Referee in Bankruptcy.—Upon adjudication the proceedings are referred by the court to a referee in bankruptcy. The bankrupt is required to appear before him for examination, and practically all other matters in connection with the administration of the estate are in the hands of the referee.

The Receiver in Bankruptcy.—In order to conserve the assets of the alleged bankrupt pending adjudication and the election of a trustee in an involuntary action, and pending the election of a trustee in a voluntary action, the court has power, upon the application of a creditor, to appoint a receiver, whose duty it is to take charge of the bankrupt's assets and preserve them for delivery to the trustee.

Upon sufficient cause shown, the powers of the receiver may be extended beyond those of a mere custodian. The receiver may be authorized to sell the assets, or to conduct the business if, in the opinion of the court, either course is necessary to protect creditors.

The Trustee in Bankruptcy.—A first meeting of creditors must be held not less than ten days nor more than thirty days from adjudication. At this meeting the creditors may examine the bankrupt under oath and elect a trustee whose choice is determined by a majority vote in number and amount of claims represented by creditors present at the meeting in person or represented by attorney holding proxy. The trustee elected must be approved by the referee.

The assets of the estate are offered for sale by the trustee, if they were not previously sold by the receiver. Sales must be by public auction, or in extraordinary cases at private sale, when permitted by special order of the court. Assets offered for sale must first have been appraised by three appraisers; they must not be sold for less than 75 per cent of their appraised value without a special order.

Distribution of Assets.—Within six months after adjudication, creditors desiring to participate in the distribution of the assets are required to file proofs of their claims on prescribed official forms.

The claims filed are subject to the trustee's scrutiny, whose sworn duty it is to object to any claim that he believes to be improper or incorrect. In any issue raised by the trustee to disprove the claim as filed, the burden of proof rests upon the trustee; the creditor's affidavit thereto makes a prima facie case in support of the claim as filed.

Distribution to approved creditors from the proceeds of the estate is made by the trustee, and may begin within thirty days after adjudication and continue thereafter, as provided by the Act, until the estate is closed. The final dividend must not be declared within three months of the first dividend.

The Bankrupt's Discharge.—Not less than one month and within twelve months after adjudication, the bankrupt may apply for a discharge. All creditors are notified of the application and any creditor may enter his appearance in opposition.

The Act specifically sets forth, in Sec. 14-b, grounds for opposing the discharge. These grounds are that the bankrupt has committed an offense punishable by imprisonment; has destroyed, mutilated, falsified, or failed to keep books of account or records from which his financial condition and business transactions might be ascertained, unless the court deems such failure or acts to have been justified under all the circumstances of the case. Discharges may also be opposed upon the grounds that the bankrupt had obtained money or property or credit, or obtained the renewal or extension of a credit by making, publishing, or causing to be made or published in any manner whatsoever, a materially false statement in writing respecting his financial condition; has at any time subsequent to the first day of the twelve months preceding the filing of the petition, transferred, removed, destroyed, or concealed any of his property with the intent to hinder, delay, or defraud his creditors; has been granted a discharge in bankruptcy within six years; has in the course of the proceedings refused to obey any lawful order, or answer any material and approved question; has failed to explain satisfactorily any losses of assets, or deficiency of assets to meet his liabilities.

A discharge, when granted, releases the bankrupt from any further liability to the creditors listed in the schedules, or who have filed claims. Certain debts specified in the Act are not dischargeable in bankruptcy.

Compositions in Bankruptcy.—The proceedings in bankruptcy may be terminated by the bankrupt filing an offer of composition, and its acceptance by a majority in number and amount of his creditors.

A meeting of creditors is called immediately upon the filing of the offer of composition, to give them an opportunity to examine the bankrupt, and to determine whether or not the offer shall be accepted. If the offer is accepted, an application is made to the court for confirmation.

Only creditors whose claims have been properly filed and approved are allowed to vote on acceptance of compositions.

In composition cases a creditor has six months within which to file his claim, the same as in other bankruptcy cases, but it is highly important that he file his claim promptly as the debtor is required to put up only sufficient money to cover claims scheduled by him and those of creditors filed and approved. Frequently a debtor either fails to schedule a claim or he schedules an incorrect amount. Should the creditor affected not file his claim and the money be distributed by the distributing officer promptly, he would receive no dividend, or only his pro rata share of the amount scheduled by the debtor, even though he might file his claim within the six months period.

Objections to the confirmation of a composition are heard and determined in the same manner as are objections to discharge.

Offenses in Bankruptcy.—Section 29 of the Act sets forth the punishable offenses of bankrupts, referees, trustees, receivers, custodians, or other officers of the court. Concealment of assets, fraudulent appropriations, destruction or falsification of books, records, and documents, bribery, perjury, and conspiracies to defeat the Act are specifically set forth as serious and punishable offenses.

It is this section which gives teeth to the Act. Elaborate provisions are made to nullify preferential transfers within four months of the proceedings and to recover unlawfully and fraudulently transferred property.

The Genius of the Bankruptcy Act.—Formal and informal procedures are provided by the terms of the statute. The formal procedure appertains to the court; the informal procedure appertains to the creditors. The law's efficiency depends solely upon the constructive manner in which the courts and creditors accept and carry out their respective responsibilities. Shirking or evading responsibility by either obligor under the law, weakens its administration and encourages fraudulent practices.

The courts are expected in performance of their exclusive privilege of appointing referees in bankruptcy, to select on the basis of fitness alone; the same conscience should be exercised by the courts in selecting receivers, and in executing all of the tasks devolving upon them by the terms of the statute.

Creditors are expected in the performance of their obligations to attend meetings in person, or by proper representation; to see that the bankrupt is properly examined at the first meeting of creditors, or on a composition offer; to oppose discharges when proper grounds exist for the action; to prosecute the bankrupt if he is guilty of a punishable offense; to see that the assets are properly liquidated and apportioned by the trustee.

Dissatisfaction with the Law's Administration.—Evidently the courts and the creditors have not lived up fully to the obligations imposed upon them by the law for its efficient administration. Referees have not in all instances been wisely selected; receivers are appointed frequently for personal reasons and not because of their fitness; bankruptcy jurisprudence may have lacked for some jurists a professional appeal.

Upon creditors rests the greater fault for complaints of the law's economy and protection. Responsibility for attending creditors' meetings in person or by proper representation is too largely neglected. Proxies are given promiscuously for trifling bribes or for no consideration whatsoever to ambulance-chasing collection agencies or attorneys.

The claims are used in many instances in opposition to creditors' interests. Trading is indulged in for the election of trustees and appointment of attorneys. Unfair compositions are rushed through by the connivance of holders of proxies, often to the chagrin of referees and courts.

Legal practitioners of standing have been offered no encouragement to enter bankruptcy practice. Bankruptcy cliques have appeared in metropolitan cities, and function often with an utter disregard of decent standards. Creditors have too frequently failed as obligors under the Act.

Remedies for the Situation.—Credit cannot accomplish proper results without a uniform treatment of debts and an equality of creditors. A federal insolvency law must be a permanent institution; its terms and administration must accord with present-day conditions, or unfairness and fraud will too largely prevail. Obligations imposed by a federal bankruptcy law must not be neglected; a proper proportion of assets liquidated in bankruptcy must be distributed to creditors.

Public attention has been aroused by unpleasant exposures of lax and unfair methods in bankruptcy administration.

Honorable William J. Donovan recently completed an extensive probe into bankruptcy administration, as counsel to the Association of the Bar of the City of New York, and the New York County Lawyers Association. His report is exhaustive and recommends a complete change in the administrative features of the present law. It is being published as a public document by the Government Printing Office.

Colonel Donovan recommends the creation of a "Federal Bankruptcy Commissioner" to coordinate and supervise the administration of the law throughout the country, and the substitution of licensed trustees for the existing system of trustees freely selected by creditors. His plan, which is concurred in by the Bankruptcy Committee of the National Association of Credit Men, embraces certain features of the English and Canadian system, and provides for a limited form of creditors' control.

While recognizing the fact that the free election of the trustee by creditors through the use of proxies and powers of attorney, is at the root of many of the faults of administration under the present law, Colonel Donovan has framed his proposals in such a way as to preserve for creditors the right to exercise the franchise whenever a substantial number of them are sufficiently interested to do so.

The plan embodies important changes in the structure of the law for the purpose of promoting economy and handling of estates, and discouragement of unprofessional and unethical practices. The bankruptcy law is the credit manager's protective weapon. Neglects of the past should be remedied, and such improvements of the law's basic structure as are needed to minimize extravagance and fraud should be supported.

CHAPTER XIX

CREDIT CRIMES

Credit Dishonesty.—The credit transaction lends itself readily to unethical and dishonest practices; it is this fact that places great emphasis on the character element. "Willingness to pay" is the credit manager's eternal question when measuring the credit risks, and the redemption of the debtor's promise it attended with material and moral hazards.

The value received may be more than the debtor's capacity can use profitably; the absence of ability may prevent the debtor from redeeming his promise. On the other hand, the willingness may be absent when an opportunity occurs to secure more than a reasonable profit by defaulting on his promise. Any arbitrary curtailment of a debt is unethical; depriving creditors of their rights in credit transactions is dishonest; the practice of paring obligations by unearned discounts and unprovable claims is a pressure on honesty that offenders, frequently, do not recognize. Commercial crimes are often the fruition of unethical habits. The steps may be progressive from making an unjustified claim to the perpetration of a criminal scheme.

Unpunishable Frauds.—Obtaining goods with no intention to meet the obligation is just as fraudulent as to obtain the goods or money by false representations; the difference is that the first cannot be punished. According to the moral code the unpunishable fraud may be just as heinous as the punishable transaction, but unless the law intervenes it may be used as a plaything by crooked debtors. Operating just within the law is a pastime for the vultures of credit. It will happen at times that heretofore honest debtors, upon finding themselves in a financial pinch, will throw honesty aside, default, and settle in any fashion that will not put them in danger of legal punishment.

Punishable Credit Frauds.—The treatment of credit crimes and their prosecution form one of the most interesting narratives in the expansion of credit commerce. Common-law crimes proscribed by the various states, included offenses against credit contracts, which were made punishable as violations of the rights of property.

Prosecuting fraudulent debtors under common-law practice was difficult and dangerous, however. The common thief or the ordinary embezzler was prosecuted by the proper officer upon visible evidence of the crime; the debtor's crime was usually not visible. It had to be proved by figures and records that the offender might falsify or conceal. It was less difficult for the prosecuting officer to prove that a theft or an embezzlement had been committed, than to prove the falsity of a financial statement.

If the prosecution were undertaken upon the complaints of creditors, and the debtor was not proved guilty, there was danger of an action for damages.

The difficulties of proving the commission of credit crimes, when no facilities were available to obtain the necessary evidence, encouraged the fraudulently inclined. Creditors were helpless in this situation, and submitted usually to fraudulent losses. They preferred to do this rather than to seek the punishment of offenders when the odds were so greatly against them.

Prosecutions would sometimes be instituted for the purpose of terrifying debtors into paying. If the procedure did produce a settlement from the fraudulent debtor, creditors would, as a rule, withdraw from the prosecution and leave the state stranded. Between the difficulties of proving the frauds, and the venal way in which prosecuting attorneys were often treated, credit contracts were not vigilantly or systematically protected against punishable frauds. In cases where creditors were able to sustain their complaints, prosecuting attorneys were suspicious of their motives. These officers justifiably resented the use of their departments for collection purposes.

Until credit managers organized, the punishment of credit crime seldom occurred; the need of reducing losses due to credit crime was one of the motivating causes for the organization of the National Association of Credit Men. A fund of $10,000 was raised, early in the association's career, for prosecution purposes. Progress was slow, for the legal highway had to be cleared; crimes against credit had to be designated in clearer language than prevailed in existing statutes; the production of necessary evidence had to be simplified.

Legal Helps.—Cooperation made it less easy to perpetrate fraud, and within recent years there has existed a jointness of law, spirit, and facility for the suppression of credit crimes. Proving the falsity of a financial statement had formerly been attended with great difficulties; the false statement laws enacted in nearly all of the states simplified the prosecution procedure, and preparing the financial statement must be done now with more regard for the truth. Prosecuting offenders for obtaining goods or money on false financial statements offers no dangers when the provisions of the acts are followed.

The United States mail cannot now be used, without grave risk, for the promotion of fraudulent schemes. Should goods or money be obtained by means of false financial statements transmitted through the mail, the defrauded creditors may elect to prosecute the offender for a misuse of the mail, or they may resort to state jurisdictions for prosecution under False Statement Acts.

The bankruptcy law was greatly strengthened through recent amendments that provide punishment for certain offenses. Imprisonment not to exceed five years is imposed upon bankrupts for the fraudulent concealment of assets; for making a false oath or account in bankruptcy proceedings; for concealing, destroying, or falsifying books of account in contemplation of or after bankruptcy adjudication. A similar punishment is decreed for trustees and receivers found guilty of certain offenses. The filing of false claims in bankruptcy, and conspiracies with bankrupts to defeat the Act, are made punishable offenses.

Organized Prosecution Efforts.—Simplification of procedure and evidence building resulted from the pressure of organized credit movement for efficient prosecutions. In the immediate post-war years a spirit of lawlessness broke out in the commercial field, and unethical practices were followed by a torrent of credit frauds. Conspiracies to defraud commercial creditors were developed with keen craftiness, and succeeded in too large a measure. The losses due directly to credit crimes were computed in one year at more than a quarter of a billion dollars. The situation was a direct challenge to credit departments; after a close survey of the fraudulent operations and the extent of sanitary work necessary to curb the evil, the National Association of Credit Men concluded that a fighting fund approximating 2 million dollars would be required.

No movement of equal extent for credit protection had ever been entertained in commercial circles, but convinced of its necessity, the association entered upon an expertly conceived campaign, and in 1925 the financial objective was reached. Divisional departments were set up in the association's offices at New York, Chicago, and San Francisco. A number of trained investigators were located at strategic points in each division, and the machinery as finally installed was in every way equal to the task of fighting commercial crime with a relentlessness and a diligence that had never before been seen in financial history.

The purposes of the Credit Protection Department appealed to and received the cordial cooperation of the Department of Justice, the Postal Department, federal and state prosecuting attorneys, and was quickly recognized and respected throughout the business world.

The statistics of this sanitary credit work are impressive. From June 1, 1925, to March 1, 1930, the department accepted 1,487 cases for investigation. Indictments were found against 1,891 individual offenders, and 897 convictions were secured; 898 cases were still pending. Resulting from the investigations, concealed goods and money were discovered amounting to a million and a half dollars; these recoveries were shared by the creditors interested, and no financial benefit resulted to the department. The intelligence, persistence, and constant energy of this work has had a perceptible effect on credit crimes. Offenders understand that when the Credit Protection Department undertakes an investigation, no influence or money offer can deflect its operations.

The fund for the suppression of credit crime and the punishment of credit banditry has been excellently used in full accord with all guaranties to subscribers, as its record of investigations and convictions clearly attest. The need of replenishing the fund occurred in due course, and was met by the launching of a second campaign for financial support. This will bring into the association's fighting chest well over a million dollars.

Typical Cases of Credit Frauds.—In a large number of successfully prosecuted cases a master mind was revealed—a combination of criminality and shrewdness that intrigued weaker minds by glittering promises of quick riches. The usual run of business operators who would defraud their creditors for a quick turn, seldom possess the shrewdness to concoct schemes that will attain their ends and yet be difficult to detect. The credit "racketeer" is usually smoked out in the cases diligently and successfully investigated.

Misuse of the Mails.—In Detroit the owner of a business was induced by a crafty individual to enter into a secret agreement by which the ostensible ownership of the business would be transferred to this second party. On taking charge of the business, this master mind held himself out to be owner and transmitted false financial statements through the mails. Upon receiving new merchandise the underground work began, and in a little while the putative owner claimed that his store had been robbed in the night and thousands of dollars in merchandise taken away. Close upon this fabrication a voluntary petition in bankruptcy was filed, the fellow disappeared, and little was found left for the creditors.

Suspicious of the circumstances, some of the creditors filed a complaint with the Credit Protection Department. Clues were closely followed and after the most diligent search the thief was located in Washington, D. C. An indictment followed, and while at the trial this crafty criminal claimed mistaken identity and squirmed like an eel to evade punishment, after a three days' trial a verdict of guilty was handed down, and a sentence of two years in the Atlanta penitentiary was imposed.

In the city of New York a business had been operating for a number of years and its reputation was well established. On the death of the founder, the business passed into the control of a nephew and another close relative. These men were not content to make money slowly, and they fell into the hands of a "fence" in Philadelphia, who was well known for his deftness in conceiving safe methods for stealing. This racketeer sent some of his lieutenants to advise the impatient young men how to make a "killing."

When the conspiracy was ready for operation, a second establishment was opened a short distance from the original location. This new store, trading on the reputation of the founder of the business, was used to purchase goods that had no connection whatsoever with the merchandise traded in by the organization. As the goods were received, resales were rapidly arranged for cash at almost any price. Credit obligations were not paid and the creditors petitioned the concern into bankruptcy; the liabilities were listed at $160,000.

In the old days this criminal scheme to defraud might have done nothing more than leave a bad taste with creditors, but the conspirators evidently had not counted upon the prompt and active intervention of the organized movement for credit protection. Dissatisfied creditors set the machinery in motion; a diligent investigation, in which Post Office inspectors splendidly assisted, revealed the ramifications of the conspiracy; goods had been obtained by the fraudulent use of the mail, and indictments were found against eight of the conspirators. Two of them fled, however, to Italy before the grand jury had acted—these two being the young men who inherited the business. The other six entered pleas of guilty and received prison sentences.

Assumed Name Frauds.—The crafty operator discovered possibilities in copying closely or exactly the name of a successful enterprise for the purpose of ordering goods, disposing immediately and for cash any that were delivered, and decamping before the fraud was discovered. This scheme resulted in defrauding many houses of large sums until organized credit management made it exceedingly dangerous.

In a North Carolina city a successful business was operated as a "Mercantile Company." There appeared in this city two unnaturalized aliens, who resorted to the nefarious scheme which had yielded such large returns in the past. Fixing a location on the same street with the reputable concern, they broadcast typewritten orders over the name of a "Merchandising Company." Many of the orders were executed in the belief that they had come from the well-established concern. Suspicions were eventually aroused and the Credit Protection Department initiated an investigation on its own motion; the work was done so well that the fraud was soon bared and the facts discovered led to the indictment and imprisonment of the two offenders.

In Baltimore a successful business was operating as the Exclusive Garment Shop, Inc. Three old offenders looking around for some place to ply their trade selected this successful business for the performance. A loft was rented in the neighborhood of the well-rated concern; orders were sent promiscuously by mail over the name of the Exclusive Garment Shop. As had happened frequently, a number of these orders were executed without investigation. Suspicions were aroused before the conspirators could complete their operations; upon complaint to the Credit Protection Department at its office in Baltimore, an investigation was started and an expert Post Office inspector cooperated. The conspirators were discovered and sufficient evidence unearthed to bring about their indictment for violating the Postal law; convictions followed, and the three offenders were sentenced to from two to three and one-half years in the penitentiary.

Concealment of Books.—A voluntary bankrupt had failed to file schedules; these were produced later, signed but not sworn to. Liabilities of $40,000 and virtually no assets were shown. Dissatisfied creditors called upon the Credit Protection Department and the case was accepted. After a thorough search had been made of the bankrupt's premises, no books of account could be found; facts were gleaned, however, which indicated clearly that books of account had been kept, and the suspicion became strong that were it possible to obtain the books, they would show merchandise unaccounted for in the schedules.

The facts were so strong in this case that the bankrupt was indicted for concealing his books of account; the offender was found guilty and sentenced to a brief period in the penitentiary and to a probationary term of three years.

Concealment of Goods in Bankruptcy.—A hardware concern in Massachusetts had been operating for several years and had established a good paying record. A master mind in crime picked the owner of this business as a good mark for his scheming brain; retaining a dishonest attorney to approach the owner, a scheme was unfolded for defrauding creditors in a wholesale fashion. The scheme was to buy goods in large quantities, secrete them as they arrived, eventually assign, and make a small settlement with creditors. The owner did not have resisting power; a truckman was inducted into the conspiracy, and the plan worked beautifully for a while. The master mind advanced sufficient money to discount purchases until full confidence in the concern had been established; as the goods began to arrive in large quantities, secret storage places were filled.

An assignment was then made by the owner; the attorney implicated in the plot was retained as counsel. The creditors were not satisfied with the appearance of things and an involuntary petition in bankruptcy was filed. The schedules when submitted in the bankruptcy procedure did not contain the concealed merchandise.

When called upon for assistance in this case by creditors the Credit Protection Department assigned a competent investigator to trace the clues; the conspiracy had involved 362 distributing houses and the indebtedness amounted to $100,000.

During the course of the investigation, the removal of merchandise from one place of concealment to another was witnessed. The case was difficult to prosecute, as the legal mind of the conspiracy had thrown a smoke screen about it, but the net was gradually tightened around the conspirators. Realizing that the scheme had lacked the smoothness that was anticipated, and anxious to avoid the talons of the law, an offer to the creditors was made of full payment if the prosecution was dropped. Some of the creditors tried hard to make the offer effective, but the department refused and urged every creditor to proceed with the case. When convinced that the game was up, the master mind disappeared; the remaining offenders filed pleas of guilty and were punished.

Four years elapsed. The master mind who had fled to Europe probably felt that it would be safe for him to return. During this entire period, however, the Credit Protection Department had kept him under observation, and as he walked down the gangplank, a representative of the department and a Deputy United States marshal were there, ready to receive him. Within twenty-four hours this offender was before the court in Boston; he entered a plea of guilty and was sentenced to eighteen months in the penitentiary.

Illustrating the tireless persistence of the Credit Protection Department in getting its man, a dealer in small wares in a Massachusetts city had furnished his supply houses with financial statements claiming a net worth of approximately $20,000; this dealer disappeared and an involuntary petition in bankruptcy was filed by creditors. Debts were discovered in the sum of $50,000, and the assets brought in liquidation $1,200.

Creditors complained to the department and an investigation resulted. The debtor was found to have sold goods before his disappearance, and the proceeds were evidently pocketed; the federal grand jury found an indictment against the debtor for concealment of assets. The Department of Justice cooperated in tracing the offender, and he was eventually located in Los Angeles. On being returned to Boston he entered a plea of guilty and received a prison sentence.

These typical stories of credit crimes successfully prosecuted could be repeated in hundreds of instances where organization has shown its determination to suppress credit banditry.

The Attitude of Creditors.—Crime has been encouraged in commercial circles by a disposition of creditors to compromise with offenders. The technic of credit criminality is to secure large quantities of goods on credit terms, then to pay for a part of the goods in a bankruptcy proceeding or by direct compromise. If the creditors do no more than grumble and take no steps to unearth the fraud, the conspiracy has succeeded and a money haul is made.

The systematic and relentless prosecution of punishable credit fraud is the antitoxin for the insidious infection. Sales and loans must be protected by a police surveillance set up and maintained by creditors. Above all things, salvaging the crooked estate, or receiving full payment, must not be entertained as a bribe for an immunity bath.

CHAPTER XX

FRIENDLY LIQUIDATIONS

The Judicial Liquidation.—When the debtor's affairs become involved and it is no longer possible for a debtor to meet his obligations in an orderly way, the law provides for an equitable treatment of his property.

The judicial liquidation most familiar to us is that conducted under the provisions of the National Bankruptcy Law, which places a debtor and his property in control of a United States district court. The liquidation of a bankrupt's property is performed under the scrutiny of the court's representative, a referee in bankruptcy. The proceeds of liquidated assets are distributed among creditors according to the provisions of the law, and the bankrupt is discharged from further liability upon the court's approval.

The judicial liquidation conforms to specific provisions of the law or the judgment of the court. Debtors conforming to orders and directions are of equal standing before the court irrespective of their fundamental differences. Procedures must be followed no matter how far the circumstances of the case may make them unnecessary.

It is this fact that prevents economies in credit liquidations that would be entirely possible if the control were not judicial. It is but natural that liquidations so conducted and controlled should consume a large portion of the proceeds from liquidated assets for the payment of costs. The law's inflexibility invites in many instances the contraction of costs without a compensating reward. The wily practitioner can impose charges on the administration of bankrupt estates that are legal but unnecessary, and bankruptcy administration has become unfortunately synonymous with small dividends to creditors.

The Attorney General of the United States reported for the year ended June 30, 1928, 59,398 bankruptcy cases. The liabilities involved amounted to the enormous sum of $830,788,611.00. All of the property taken over in these cases by receivers, trustees, and other officers of the court, brought $90,540,062.00; with no costs as yet deducted, the sum available to creditors was on the average less than 11 per cent of their claims. From the proceeds realized referees in bankruptcy received in fees about two and one-third per cent. The attorneys retained in the cases received eight and one-half per cent. Receivers, trustees, and marshals received in commission three per cent. Other expenses accounted for nine and three-quarters per cent. The ratio of expense to proceeds was a little more than 22 per cent. General creditors representing $621,372,000.00 in claims received $39,172,655.00, or about 6½ per cent.

Fairness dictates the explanation that this pittance of a return represents an average of the asset and non-asset cases. Were it possible to select from this large number of bankruptcies the commercial cases, the distribution to general creditors would be found to exceed the average, but still the dividends would be small on account of liquidation costs.

The Los Angeles Wholesalers Board of Trade, during the twelve months ended October 31, 1929, controlled by court approval 83 bankruptcy estates. In these cases there were 1,865 creditors representing claims of $440,853.00; the average dividend paid the creditors was 18 per cent.

The Extra-Judicial or Friendly Liquidation.—When the investment of a debtor has been entirely wiped out whatever property is left in his estate morally belongs to the creditors. The law does not permit them to step in and appropriate their proportionate shares of the debtor's property, however, except upon agreement between themselves and with the debtor's concurrence, or through court procedure.

In cases where judicial action is unnecessary it is a sensible procedure to take whatever remains of an insolvent debtor's assets and divide the proceeds ratably, at a minimum of cost and time. Where the debtor's fairness or honesty is unquestioned, and the claims of creditors are undisputed, the liquidation of an insolvent estate is an economic rather than a judicial matter and common sense and economy have dictated an increasing interest in the liquidation of insolvent estates out of court.

The friendly liquidation would be difficult to apply without the equality of creditors provided in the National Bankruptcy Act, which places them on a common ground, except when they hold permitted preferential positions for special reasons. The judicial mind has been critical of extra-judicial liquidations; but none the less it is a wise and proper procedure for creditors to cooperate among themselves, and with debtors, to secure the largest recoveries possible on their claims.

The fact that creditors generally receive a larger percentage of returns from their claims in out-of-court liquidations than in bankruptcy proves the importance of modernizing the Bankruptcy Act. The purpose of the bankruptcy law is to give more economical, equitable and expeditious administration of the bankruptcy estate and to protect the deserving debtor.

Due largely to a changing economic condition the bankruptcy law is failing to fulfill its purpose, and creditors, in order to protect their interests, must frequently utilize the extra-judicial procedure. The remedy would seem to lie in the elimination of the unnecessary legal red tape and the substitution of a common sense, business man's administration. Should this be done virtually all insolvency would be administered in the bankruptcy courts, and unscrupulous debtors would be able no longer to induce creditors to accept unfair settlements by threatening bankruptcy as the alternative.

The Development and Conditions of Friendly Liquidation.—About five decades ago the board of trade of San Francisco conceived the plan of taking over the assets of insolvent debtors in whom its members were interested, liquidating the assets and dividing the proceeds ratably among creditors. With no bankruptcy law to control the competition of creditors, the process of friendly liquidation was possible only by the voluntary acquiescence of creditors and debtors; the economy of the plan was demonstrated by the results obtained.

The National Association of Credit Men recognized in its early period the economies and value of bending creditors to a clear recognition that cooperation could show a great saving; departments were established in a number of cities by local organizations of credit men for friendly liquidations, and departments of trade bodies have been organized and are functioning in the friendly adjustment field.

It is a wise and saving practice of creditors, when debtors are not tainted by fraud and suspicion, to apply the friendly procedure for adjustments and liquidations. The friendly liquidation is flexible, and the creditors, when adjusting the affairs or handling the assets of an insolvent debtor, can act in conformance with the circumstances of the case and be limited only by their joint judgment.

Upon surveying the situation it may seem wise to the creditors to continue the business by putting it in charge of a committee, or by permitting the owner to control it under supervision. The personal contact and interest of creditors permit a disposition of the case in this fashion, when in a judicial liquidation it would not have been possible with equal freedom.

The creditors may decide that the merchandise can be sold to better advantage privately and in small lots, than by auction and in larger lots, and such a decision can be carried out when the creditors are in control of the liquidation. In friendly liquidations debtors turn over to their creditors their affairs to adjust with fairness and efficiency; the creditors compose a personal tribunal, unhampered by judicial rules and founded upon the natural desire to avoid unnecessary costs.

Creditors are required to observe scrupulously the rules necessary to preserve fairness between themselves and justice to the debtor; as an informal process, the creditors' control and liquidation must rest on sincere cooperation, competency, and economy. No preference must be permitted one creditor above another when their claims are on a parity; this is a cardinal rule of friendly liquidation.

The control must represent unanimous agreement. At times a small creditor will decline to accept and abide by the terms of a friendly adjustment; the refusal is based usually on the hope that the more largely interested creditors will pay the objector's claim in full, rather than have the friendly settlement disturbed. As a single small creditor is generally without recourse to bankruptcy, friendly liquidation, with the debtor's assent, may be carried through despite the dissenting claim.

The debtor to deserve a friendly adjustment of his affairs must have acted with entire fairness to his creditors. All that the debtor has must be turned over to his creditors without a suspicion of concealment, or any offense against law and ethics. Whenever a debtor has not been fair, or is suspected of fraudulent practices, he should be subjected to bankruptcy. The debtor's examination under oath in bankruptcy is an opportunity for creditors to unearth hidden facts; concealment is a crime only when committed against officials in bankruptcy.

After making a clean breast of his affairs and turning over to creditors all of his assets for liquidation and ratable distribution, the debtor should be granted a release and accorded any other consideration allowed by the Bankruptcy Law. The friendly liquidation places a direct obligation upon creditors to adjust the affairs of a debtor and liquidate his assets with the dispatch, efficiency, and economy possible to an informal and flexible procedure. The obligation should not be carried out by the creditors themselves acting as adjusters, but should be assumed by an agency set up by the creditors as their representative.

This arrangement continues the responsibility of creditors, but centralizes the mechanics and detail in the hands of their appointed agency. Obviously, the agency must be qualified to protect the interest of creditors and the fairness due to debtors. It must be responsible and accountable always to the creditors it represents. The economies of the friendly liquidation, and the character of the agency qualified to execute properly the creditors' obligations, appealed forcibly to the National Association of Credit Men; the structure of that organization permitted the establishment at strategic points in the country of adjustment bureaus owned and controlled by local credit organizations. In the Far West several independent liquidating organizations, known as boards of trade, operate in close cooperation with the local associations of credit men.

The Adjustment Bureau and Its Operations.—The adjustment bureau is usually a corporation whose stock is entirely or largely owned by the organizing credit association. The directorates of the bureau and the association are usually interlocking; this structural plan of the bureau places upon the controlling association a direct responsibility for its good faith and efficient work.

The responsibilities and duties of the bureau's manager are delicate, important, and manifold. As opposed to the impersonal nature of the judicial liquidation, the manager's contacts with distressed debtors are personal and direct. Where the court can command the debtor's actions, the manager of an adjustment bureau must in many instances induce the debtor to realize the wisdom of acting as he suggests.

Tactfulness in handling people is a requisite of good bureau management. The debtor, when insolvent or embarrassed, and especially when disappointed over his condition, will not react normally. Bringing the debtor to see the expediency and economy of cooperating with his creditors so that everything possible may be salvaged from his estate, demands a knowledge of human nature, patience, and tact.

Creditors are at times more difficult to control than debtors. A failure or an embarrassment will usually involve creditors over a wide area. Many of them cannot be reached for personal interviews, nor will they be able to attend creditors' meetings, and distant creditors are often recalcitrant from no reason but irritation over the threatening loss. Bureau managers must overcome creditor objections in worthy cases by convincing presentations of the debtor's financial condition and the economies of friendly liquidation.

The manager must be alert to any suggestion of fraud or unfairness in the debtor's affairs, and must be assured that the debtor has come to his bureau with clean hands. The manager must be legally trained or enjoy sound legal advice so that in accepting and handling the properties of insolvent debtors, every step in the procedure will accord with law.

The debtor's affairs must be wisely appraised by the manager, so as to determine the form of treatment that will best protect the creditors' interests, and also be fair to the insolvent. Whether or not a compromise, an extension, a continuance of the business, or a liquidation is the wisest course to pursue, will be determined largely from the investigation and report of the bureau manager and the creditors' committee.

A knowledge of merchandising is important to efficient management, as securing everything possible from the stock of merchandise has a great deal to do with the amounts that will be realized for creditors. The private sale or the public sale, whichever will yield more, can be resorted to in a friendly liquidation.

From the beginning to the close of an adjustment exact records of each step in the process must be kept under the manager's supervision, and important facts disclosed promptly to the interested creditors. Certain pivotal steps in the friendly adjustment should first be considered and approved by the creditors, and the proceeds from liquidated assets must be distributed promptly and ratably among the creditors. A creditors' committee should be appointed in every case if possible, to supervise the administration and to advise the bureau manager.

This agency of creditors for friendly liquidation is not operated for profit. The charges imposed, usually, for its services are expected to cover operating costs.

When it happens for debtor or creditor reasons that the friendly liquidation is unwise to attempt, or impossible to accomplish, the adjustment bureau will offer its services to administer the estate in bankruptcy through its manager serving as trustee. The bureau will represent members of the association in bankruptcy cases and will look after their interests. Some of the bureaus offer collection service to association members, through a department especially organized for the purpose.

The National Association of Credit Men supervises the adjustment bureaus. The fairness and efficiency of their work are carefully inspected, and complaints are promptly investigated. The economy and dispatch of bureau adjustments have a strong appeal and the records show that of the hundreds of cases brought to the bureaus each year, not more than 8 per cent are forced into bankruptcy. The remainder are liquidated or otherwise adjusted through the friendly procedure. Approximately 5 per cent of the estates taken over by the bureaus are rehabilitated and turned back to their owners; about 15 per cent of the cases are settled by compositions.

How Friendly Liquidation Cases Originate.—A debtor concern may find itself financially embarrassed; maturing bills cannot be paid. The situation is disclosed to an interested credit manager who advises the debtor to place his affairs in the hands of a bureau. A debtor's affairs may be investigated when his creditors discover that too large a portion of the debts is overdue. The investigation may disclose a situation hopelessly tangled, and the debtor will be advised to entrust the liquidation of his affairs to an adjustment bureau. Sometimes it will happen that an attorney may advise a debtor client to place his business with an adjustment bureau for appropriate handling. The creditors' interest is the largest factor in broadening friendly liquidations. In various ways debtors when unable to untangle themselves are led to accept the assistance of adjustment bureaus. In all cases a careful investigation is made in order to determine the best administration procedure and to disclose evidences of fraud.

When the time arrives for a debtor to transfer his assets to a bureau, it is not done in a uniform way due to differences in state laws. Some of the bureaus use a common law assignment, others use a statutory assignment, and still others, a trust mortgage. The purpose of the form used is to transfer title so that the assets may be liquidated for the benefit of creditors. The transfer of the capital stock of corporations to the bureau representatives is a common method of transferring control from the debtor to the bureau.

The Economies of Friendly Liquidations.—There can be no justification for creditors to undertake the liquidation of insolvent estates and substitute their medium for judicial action, unless there are visible economies in costs and dispatch. Fortunately, figures are available for the comparison of recoveries in friendly liquidation with recoveries in judicial liquidation. In general terms the recoveries through bankruptcy liquidation of commercial cases approximate from 11 per cent to 15 per cent. The recoveries through friendly liquidation approximate from 30 per cent to 40 per cent of creditors' claims.

The Los Angeles Wholesalers Board of Trade in twelve months ended September 30, 1929, liquidated by friendly adjustment 287 estates. The claims of general creditors totaled \$1,794,038.00, and the claims of preferred creditors amounted to \$75,043.00. The total assets transferred to the bureau by the debtor concerns inventoried 78.07 per cent of the liabilities; the assets when liquidated realized 51.44 per cent of the inventories. The bureau's charges including attorneys' fees did not absorb more than 7 per cent of the proceeds. General creditors received, on the average, after all priority payments had been made, 30.98 per cent of their claims; of the total proceeds realized from the assets, general creditors received 74 per cent. Had these estates been liquidated in bankruptcy, general creditors would probably have received no more than 15 per cent of their claims; the liquidating costs would probably have averaged 20 per cent; and no more than 40 per cent of the proceeds from liquidated assets would have been passed on to the general creditors.

A comparison of individual cases is possible as the judicial and extra-judical records are carefully kept. A clothing store was liquidated in bankruptcy with the manager of an adjustment bureau serving as trustee. The liquidated assets realized \$5,798.07 from which priority claims of \$680.25 were first paid. The expenses of administration were 36.29 per cent of the proceeds, and general creditors received 51.98 per cent of the proceeds. A dry goods store was liquidated by the same bureau through the friendly process. The liquidated assets realized \$6,304.86, from which priority claims of \$146.50 were deducted. The liquidation costs amounted to 10.07 per cent of the proceeds; general creditors received 87.61 per cent of the proceeds. Seventeen months and seventeen days were consumed in liquidating the bankruptcy case and four months and twenty-eight days in closing the friendly adjustment case.

The records of another bureau offer an interesting comparison. A retail grocery store was liquidated in bankruptcy with the bureau manager serving as trustee. The liquidated assets realized $2,711.95. The administration expenses were 38.87 per cent and general creditors received 33.21 per cent of the proceeds. Fourteen months and eight days were consumed in closing the estate. Another retail grocery store was liquidated by the same bureau through friendly adjustment. The estate realized $2,503.21. Administration expenses were 21.35 per cent and general creditors received 54.68 per cent of the proceeds. The time consumed in closing this estate was three months and five days.

These are not hand-picked cases. They were selected at random from a number of cases furnished by adjustment bureaus to Mr. Thomas Clifford Billig, while a member of Col. William J. Donovan's bankruptcy investigation staff. Mr. Billig had for two years examined closely into the operations of adjustment bureaus, and wrote a most illuminating thesis under the title, "What Price Bankruptcy: a Plea for Friendly Adjustment."

CHAPTER XXI

BUSINESS SERVICE

Saving Credit Waste.—Looking upon business failures as a concomitant of credit transactions was the general attitude until there appeared the realization that an improvident waste was taking place. High costs were contracted in our distributive methods and much of the saving made by highly mechanized processes did not benefit the consumer. A recognized authority estimated that eight billion dollars were wasted annually in distribution, which, projected into consumer prices, absorbs buying power that could be used for the purchase of more goods.

The capital and credit losses do not measure entirely the waste that attends business failures. A merchant in a Western city, with his wife assisting him, had built up a comfortable business on a nominal capital. An opportunity offered to expand the business and cater to a more discriminating class of buyers, but the hidden dangers were apparently not realized. Proper capital arrangements were not made, nor were credit contacts of the proper type cultivated. The new enterprise started off in a burst of enthusiasm; advertising costs disproportionate to the business were undertaken; financial pressure occurred in a short time; and within a few weeks bankruptcy engulfed the business. An inventory of this wreckage included the tangible losses to capital and credit and a number of intangible losses; a vacant storeroom with suspended rental; distress merchandise to be placed in competition with goods bought at full value; discouragement and reduced earning power for the unfortunate merchant.

Surveying our entire credit waste, it seems probable that it will account for at least one-eighth of the entire distribution waste—a billion dollars a year. The correction of this waste became the occasion of close study within credit circles. Pencil and pad revealed that on a mark-up of 20 per cent a credit loss of $1,000 was equal to the entire profits of $5,000 sales; the most impressive discovery was of the unfair and costly competition of distress merchandise. A bankrupt stock of goods bought at a fraction of its cost will create a real problem for the merchants who have paid full value for their goods, and every business failure creates this potential danger to legitimate merchandising.

The problem of saving needless credit waste had attained large proportions, due largely to its fœtid growth through neglect. Under the title of Business Service, a department was organized by the National Association of Credit Men, for the purpose, not of salvaging, but of preventing the needless failure.

Business Service.—This economic idea is in its infancy, and only incidentally known as yet in the credit field. The saving of needless credit waste will have a direct reaction on distribution costs; this saving will be realized when a practical credit therapy has become available when the first symptom of credit distress appears.

On February 10, 1930, the National Association of Credit Men made this interesting announcement: "Business service is designed to preserve the business health of debtor firms, rather than give them emergency treatment as they approach their final gasp."

Business service is the health department of credit commerce. Good credit management cannot feel satisfied with only the skill to open and to collect accounts; preserving the deserving and capable debtor is a higher skill. Through it accrues the building of safe accounts, a reduction in the credit turnover, and an indescribable satisfaction. A small bad debt loss is not nearly so commendable in credit management as converting unsafe into safe accounts.

Prevention.—Business service falls into two branches; the first is prevention. If failures happen because the rules of the business highway are not known, then disclosing these rules to deserving debtors is a sensible preventive gesture.

A proper mark-up for profits is the *sine qua non* of success.

Constantly emphasizing the need of calculating profit on selling price and not on cost price may save numbers of disappointments. The attempt to conduct any kind of business without accounting records is dangerous. The small enterprise will not need elaborate records, but they must show some indication of how the business is going. The profit and credit advantage of taking discounts when they are allowed is a string in business service that the credit manager should constantly play upon. Exercising good judgment in making receivables and persistency in collections are safeguards to success and solvency that should be prominently displayed. Keeping current assets and payables in good proportion is part of the sound advice designed to save failures.

The preventive branch of business service is designed to point out the dangers of the business highway. The personal contact can be availed of splendidly for the conveyance of constructive ideas. A tactful credit manager can quickly ascertain the parts missing in a customer's business ability, and suggestions can be made to ward off accidents. Inserts in invoices and letters serve a good educational purpose; the debtors who disregard the danger signs are of doubtful ability and diligence.

Direct results from the educational feature of preventive business service are usually not measurable. The credit department will not always be rewarded with the evidence of applied suggestions. It is as difficult to measure the exact results as it is to measure the number of accidents that are saved by warning signs on a highway, but satisfaction will be realized when it is discovered that a smaller number of mishaps are occurring.

The educational programs of business service have not been stressed long enough to justify the expectation of large immediate results. The business failure has had the momentum of years, and salvaging estates has been more prominent than saving debtors; to turn the tide in the direction of prevention will require the utmost persistence, intelligence, and patience.

Remedies.—The second branch of business service is remedial. Trouble has developed in a debtor's affairs, but it has not gone far enough to defy remedial treatment, and if the proper remedies are applied at once, failure can be averted.

Referring to the occurrence detailed at the beginning of this chapter, the unfortunate merchant was savable. The first sign of distress in his affairs was probably a difficulty in paying merchandise bills; appearances indicated that his goods were well selected and that he had good sales ability. There were outward evidences of progress; the vital trouble was in capital construction. Practical advice, backed by the forbearance and cooperation of the creditors, would have saved this failure and the heavy waste that attended it.

Discriminating judgment is needed to determine if the basic causes of a distress symptom are of a curable nature; to determine whether the business should be built up or closed down.

To illustrate: A debtor's financial affairs are troubling him, but he does not know why; he knows merely that his money on hand is always less than his maturing bills. On examination the debtor's shelves are found to contain a great deal of unsaleable merchandise whose cost value would have placed the debtor in a position to pay his bills promptly. The situation on careful study may suggest a lack of ability founded on qualities uncongenial to good merchandising. Persuading the debtor to retire before his capital has been entirely sunk and his creditors involved, would be judicious business service.

If, on the other hand, the obsolescent goods were found to have accumulated because the debtor did not know the dangers of static merchandise, and it was found that he could understand creditor counsel and revamp his operating plans accordingly, saving the debtor and keeping him in business would be the intelligent objective of business service. The symptom of slowness may result from so many situations in a business that analytical skill is indispensable in finding causes, and curative skill in applying remedies.

Individual Action.—The rounding out of a practical credit training comprehends a strong course in business service. The credit manager must include in his equipment a "first aid" credit kit.

Knowing, as the credit manager does, that accurate accounting records are indispensable to safety in the simplest business enterprises, how embarrassing it would prove were he unable to show a debtor how the records should be kept.

If convinced that a buyer is losing advantages by failing to remit on discount terms, unless able to prove the saving made by taking discounts, the credit manager is not likely to be effective.

Realizing that a debtor's weakness is overbuying, to check the tendency demands convincing statements, and not mere reprimands.

Pointing out to a debtor the value and safety of quick turnovers of merchandise, the hazards of unsaleable goods and the financial advantage of prompt payments constitute some of the important objectives of remedial business service.

Measuring credits merely and leaving the accounts to take their chances in present-day competition is not the character of individual credit action that humanity and economy demand. The financial and ethical returns bound up in skillfully applied business service are growing convincingly and having more appeal to the credit manager of genuine ambition.

Organized Action.—In many instances the debtor is unaware of any trouble threatening the integrity of his business. The pressure of past-due bills may be regarded as a trivial ailment that will soon right itself; the debtor may be overconfident of his ability and resent any imputation to the contrary. Saving a debtor in spite of himself is frequently the problem of credit doctors.

Organized action offers the most judicious and promising procedure in credit situations; the department of business service organized by the National Association of Credit Men is being featured with increasing emphasis. An executive committee of the department has produced a simple manual that explains how organized action can be applied.

The personal contacts permitted credit managers in trade group meetings develop business service cases. A member of a group will refer to an account that is giving him grave concern; other members of the group are found to be interested in the account, and a representative of the Credit Men's Association present at the meeting will ask the interested members if they desire a business service survey made of the debtor. Another prolific source of demand for business service is the interchange report. Past-due indebtedness is revealed by the report in a disproportionate amount and seemingly is serious in its nature. Interested creditors are canvassed by the bureau manager as to their desires for a business service survey.

Requests for surveys may be made voluntarily by debtors, who may become alarmed over distress symptoms and appeal to one or more creditors for a clinical survey.

Care must be exercised to prevent confusion of the business service investigator with an adjuster. The exact nature of the investigator's mission must become patent to the debtor, and to accomplish this, the investigator must be armed with proper powers and credentials.

A critical and comprehensive survey of a debtor's physical and financial affairs comprises a number of important measurements. Upon the facts obtained will depend the type of remedy eventually recommended to the debtor.

The atmosphere of the business will be observed first: how the community regards the debtor as a merchant and merchandiser; how local financial authorities regard the debtor's money affairs and his ability in business matters; the condition of the debtor's place of business and its location.

How the debtor received the investigator is an important feature of the survey.

The debtor's ability to manage is surveyed from various angles:

Inclination to overbuy.
The frequency of inventory taking.
The extent of stock turnover.
The percentage of mark-up on goods.
The kind of records and books kept.
Plans, if any, to avoid dishonesty of employees.
Kinds of insurance in force for business protection.
If goods taken from stock for debtor's use are charged to his account.

The proportion of sales on cash and credit.
If credit customers are investigated.

The financial picture in the debtor's affairs is surveyed by ascertaining—

The receivables and payables, not due and past due.
The debtor's collection methods.
Verification of bank balance.

In addition, the investigator is expected to ascertain the neighborhood's sources of revenue. Other facts not included in the above will also be comprehended in the survey. Finally, the investigator will offer his ideas of the causes that brought about the debtor's distress.

A copy of the survey and the investigator's recommendation will be sent to each creditor who requested it. The actual expenses of the survey will be apportioned among the participating creditors; the costs incurred for making these surveys on the basis of organized action have been nominal.

Each creditor receiving the survey is requested to digest its contents carefully, and to indicate to the association's business service department a recommendation of the remedy that should be applied. When the facts reveal an urgent or very critical case, the creditors will be called into meeting for a careful deliberation of the debtor's condition, and the remedy that should be applied.

The remedy determined upon will be laid before the debtor and the recommendations of the creditors must be given a genuine trial. The debtor's refusal to cooperate will generally eventuate in an adjustment bureau or bankruptcy case.

The debtor's acceptance of a recommended remedy is the important step; the manner in which his business responds to the remedy is a continuing concern of the business service department. The debtor is requested to make frequent reports to the department; creditor experience is also a weather vane as to how the ailment is yielding to the remedy. If the trouble is not cured, then an adjustment will probably be the wisest course to adopt.

Actual Business Service Cases.—A merchant in a Pacific coast city had been in business a great many years. This merchant and his creditors realized that something radically wrong had attacked the business; an investigation was suggested by certain of the creditors and it was undertaken, with the debtor's hearty cooperation.

The survey disclosed a disproportionate amount of payables to current assets. The investigator recommended certain improvements in the set-up of the business and, regarding the situation as seriously critical, called a meeting of the interested creditors and laid the facts before them. A majority of the creditors present felt, on account of the debtor's age, that the business should be quietly liquidated. The business service department regarded this recommendation as too drastic and asked for a little time in which to see if certain suggestions for reducing the debtor's inventory and receivables would not improve the situation.

The delay was granted and at the end of sixty days the situation had materially improved. The inventory, receivables, and payables had been reduced, even though the debtor had been paying cash for all new purchases. The structure of the business was entirely altered; pilfering and incompetent employees were removed; the business was saved, and the merchant is still functioning.

In a second instance, a merchant had built up a large business and was scattering his purchases over the entire country. His payables expanded rapidly, and as the merchant was usually slow in paying his bills, this extensive buying emphasized the slowness. Near-by creditors became alarmed and felt that an investigation would be helpful.

The merchant's store was modern in its appointments, his ability among local bankers and friends was rated high, and he was conceded to be an excellent salesman. His egotism also ran high. When approached by the investigator this merchant laughed at the idea of a survey. He claimed that the business was a marvelous success. He had never furnished anyone with a financial statement and did not propose to do so. The survey was emphatically declined.

The debtor eventually consented to a partial survey, but still refused to furnish operating figures of the business. The incomplete information obtained by the investigator did not permit the creditors to form an intelligent judgment of the debtor's actual condition. He was again urged to furnish the data that would give an intelligent picture of his affairs, and after a while the creditors' persistency broke down his opposition and he promised to supply them with a complete copy of his next inventory. When the inventory was taken it became apparent to the debtor that he had done a great deal of wide guessing. His books showed merchandise on hand amounting to $91,000, but the physical inventory showed an actual merchandise value of $38,000. The debtor immediately changed his attitude. His payables were spread over such a wide territory that it seemed hopeless to secure unanimous action of his creditors, and the only alternative was an adjustment.

CHAPTER XXII

CONCLUSION

In conclusion reference must be made to the rapid application of our domestic credit technic to foreign trade. The same measuring-rods determine the credit dimensions of a buyer residing in the United States or in any part of the world.

There are certain requirements, however, in appraising the capacity of a foreign merchant that are not met with in domestic transactions. The direct approach for references and balance sheets does not apply abroad; there are many fine touches in credit dealings with foreign buyers that are not found in domestic business.

The World War brought new ideas and new opportunities to our export trade, and the progress registered in our domestic credits encouraged the application of similar principles in our efforts to build up markets abroad. The manager of a foreign credit department handles transactions over long distances, and must be broadly informed of the conditions surrounding the credits he accepts, whether they are on open terms or in documentary form.

The manner in which foreign buyers should be treated is an important feature of foreign credit management; closer attention is required to certain technicalities than is necessary in domestic credits. The building of our trade in finished products rests as largely now on an intelligent credit technic as on quality and price. As no more than one-tenth of our production seeks world markets, the manufacturers and distributors of our country have been but partially internationalized, and as a rule they do not realize the direct reaction of our exports on the general prosperity. There is no difficulty in understanding how a merchant in this country may satisfy his merchandise needs on credit terms, but it is not so easy to understand how a merchant in Australia can purchase merchandise produced in this country on credit terms.

In the first instance, the domestic credit machinery has made readily available much information regarding the buyer that enables the credit department to determine promptly his worthiness for the credit favor. The machinery is not readily available for supplying information of the Australian buyer's credit capacity and aids are brought into action that have no place in the domestic transaction. In both instances the appraisals are the same and the objective is to discover how nearly the domestic and the Australian buyer measures up to the three C's of credit. The State and Commerce departments of our government have established channels of information on foreign buyers; there is a flow of useful information that has substantially helped in the building of foreign outlets.

Consular reports furnish useful and valuable information to exporters, and commercial agents in large numbers represent the Department of Commerce in all of the principal countries of the world. The information emanating from these representatives on credit conditions and the credit capacity of buyers furnish a supply of the greatest help to foreign credit departments.

The Commercial Intelligence Division of the Department of Commerce assembles and tabulates the credit information received from the department's representatives abroad. This information is available to interested exporters and forms one of the most useful services to foreign credit managers in the appraisals of their credits.

Without this government aid great difficulties would have arisen in promoting our sales abroad on credit terms. The foresight displayed in building up these facilities for foreign credit departments must, in the largest measure, be accredited to Hon. Herbert Hoover when administering the Department of Commerce, and to his efficient assistant, Dr. Julius Klein.

Following the trend displayed by domestic credit managers in forming groups for conferences, the managers of foreign credits have gravitated together, and while much smaller numerically than their domestic associates, yet are their equals in earnestness, zeal, and skill.

The idea occurred about a decade ago that the same mechanics which had proved efficacious in assembling domestic credit experiences could be availed of for assembling foreign credit experiences. This idea resulted in the organization of a foreign credit department and a foreign credit interchange bureau by the National Association of Credit Men.

A number of foreign credit departments supported the plan, and the bureau set up for assembling and tabulating foreign credit experiences has operated with increasing favor and success.

As a sequence to these movements there arose the idea that it was possible to penetrate the credit traditions of other countries with some of our practical credit ideas. Therefore financial statements are being requested now when only a short time ago such an approach would have been considered highly injudicious and apt to occasion resentment. Foreign debtors in arrears are now frequently told how slowness in meeting credit obligations is looked upon in this country and what its effect may be on their abilities to buy at proper prices and terms.

The International Chamber of Commerce is manifesting a wholesome interest in the credit problems of world trade. On the whole, considerable promise is held out of a wider adoption in our export business of the principles and ideas upon which our domestic credit technic has been founded, and which have proved of so much value in building our trade and finance.

The business machine as it is organized today cannot function without credit; as a medium of exchange it is the lubricant of trade and finance.

The tangle into which business and finance get themselves when credit is misused is due to the seeming ease in the creation of credits and the failure to appreciate the fact that a promise exchanged for value must be reexchanged for value. It has become manifest that the relation of credit to business stability has not been accorded the consideration shown to our productive processes, and there appears no training so badly needed in the field of business as that of credit.

The credit manager enjoys unbounded opportunities to control and to direct intelligently our credit exchanges. To accomplish even a moiety of these opportunities demands courage, skill, and a leadership in business circles. The credit manager chained to his desk will succumb rapidly to the dry rot that atrophies human energies and ambitions. Vision is needed to fix the management of credit in its proper sphere, and vision is not indigenous; it is the reward of doing other things than those that appertain directly to the job in hand. Credits are bound in the closest fashion to every movement of the business machine, and the successful management of credit demands a knowledge of production, finance, and distribution, aside from a deftness in handling the credit tools.

To attain the leadership offered to credit managers requires education, humanity, and zeal. Reading informative books, keeping abreast of current financial and business events, observing closely the ebb and flow of the credit stream, and being conscious of danger symptoms, furnish the groundwork of the leadership that credit managers can assume. Mingling with one's fellow workers, taking a genuine interest in credit organization, assisting in the improvement of credit machinery, helping to guide credit legislation, and being vocal on all subjects relating to credit welfare are the visible expressions of leadership.

The writer of this book has observed by the closest approach the credit panorama as it has unfolded in our development of the past four decades. He has observed with concern the pressure exerted upon intelligent credit control by the fascination of mass production, and has realized the decided drift of modern days toward mechanics rather than to human judgment in shaping credit transactions. He has seen serious disasters brought about by the misuses of credit, attended with appalling costs. He believes that the hills and valleys of distribution can be evened out in the broadest way by sound credit control. He strongly hopes that credit management will be galvanized into energetic action by the recognition of its high position and its important functions.

Leadership must be assumed by credit managers to save capital and human energies from the recurring wastes that attend the uneconomic and unintelligent uses of credit.

BIBLIOGRAPHY

Bartlett and Reed, *Retail Credit Practice.* Harper & Brothers.

Beckhart, B. H., *The Discount Policy of the Federal Reserve System.* Henry Holt & Co.

Beckman, Theodore, *Credits and Collections in Theory and Practice.* McGraw-Hill Book Co.

Chapin, A. F., *Credits and Collections, Principles and Practice.* McGraw-Hill Book Co.

Clay, Henry, *Economics for the General Reader.* The Macmillan Co.

Day, Clive, *History of the Commerce of the United States.* Longmans, Green & Co.

Dewey, D. R., *The Financial History of the United States.*

Dewey and Shugrue, *Banking and Credit.* Ronald Press.

Eldridge, F. R., *Financing Export Shipments.* Harper & Brothers.

Ettinger and Golieb, *Credits and Collections.* Prentice-Hall.

Faulkner, Harold U., *American Economic History.* Harper & Brothers.

Foster and Catchings, *Money.* Houghton Mifflin Co.

Gardner, E. H., *New Collection Methods.* Ronald Press.

Gerstenberg, C. W., *Financial Organization and Management.* Prentice-Hall.

Gilman, Stephen, *Analyzing Financial Statements.* Ronald Press.

Guthman, H. F., *Analysis of Financial Statements.* Prentice-Hall.

Harding, W. P. G., *The Formative Period of the Federal Reserve System.*

Hepburn, A. B., *A History of the Currency of the United States.* The Macmillan Co.

Holdsworth, J. T., *Money and Banking.* D. Appleton & Co.

Jennings, W. W., *History of Economy and Progress in the United States.* Crowell & Co.

Kemmerer, Edwin W., *The A B C of the Federal Reserve System.*

Kilborne, Russell D., *Principles of Money and Banking.*

Lippincott, Isaac, *Economic Development of the United States.* D. Appleton & Co.

Marks, Morris, *How to Correct Credit Abuses.* Harper & Brothers.

Montgomery, W. Randolph, *Laws and Decisions Applying to Sales in Bulk.* National Association of Credit Men.

Munn, Glenn G., *Bank Credit.* McGraw-Hill Book Co.

Noyes, A. G., *Forty Years of American Finance.* G. P. Putnam's Sons.

Noyes, A. G., *Post War Period of American Finance.* G. P. Putnam's Sons.

Olson and Hallman, *Credit Management.* Ronald Press.

Picken, J. H., *Credit and Collection Correspondence.* McGraw-Hill Book Co.

Schluter, W. G., *Credit Analysis.* Prentice-Hall.

Steiner, W. H., *The Mechanism of Commercial Credit,* D. Appleton & Co.

Strain, M. M., *Industrial Balance Sheets.* Harper & Brothers.

Tregoe and Whyte, *Effective Collection Letters.* Prentice-Hall.

Wall and Duning, *Ratio Analysis of Financial Statements.* Harper & Brothers.

Ward, Wilbert, *American Commercial Credits.* Ronald Press.

Warshow, H. T., *Representative Industries of the United States.* Henry Holt & Co.

Young, Robert, *Industrial Credits.* Harper & Brothers.

INDEX

Accounts, 120-128
  closing, 120
  credit, 121
  difficult, 124
  open book, 29
  slow, 123
Alaska, 133
Assets, distribution in bankruptcy, 152
Attorneys, collection, 126

Bank, a reservoir of credit, 38
  credit based on gold, 71
  liability for collection of checks, 133
Banking, credit offered in, 28
  need for flexibility, 12
Bankruptcy, acts of, 150
  compositions in, 153
  concealment of books, 163
  concealment of goods, 164
  demand for uniform law, 9
  discharge in, 152
  distribution of assets, 152
  law regulating, 146-156
  legislation in United States, 147
  offenses, 154
  officials acting in cases of, 151
  persons who may claim, 149
  prevalence of, 168
  proceedings in, 150
  remedies, 155
  significance and purpose of, 146
Bankruptcy law, 9, 132
  Act of 1898, 149
  credit and the, 146-156
  dissatisfaction with administration of, 155
  genius of the, 154
  negotiable instruments, 133
  strengthened by punishment provision, 159
Bar Association of City of New York, 155
Bibliography, 191
Billig, Thomas Clifford, work on liquidation, 176
Bradstreet's, 98
Bureaus, adjustment, 172
  central, 96
  credit interchange, 92
Business, departmental control, 43
  failures (*see* separate item)
  mortality in, 138
  need for surplus, 84
  service (*see* separate item)
  statements, 78 *et seq.*
Business law, 129-137
  bad check, 137
  bulk sales, 135
  exemptions, 132
  fictitious name, 136
  frauds, 129
  landlord's lien, 131
  sales and cancellations, 130

Canada, bankruptcy system, 156
Charles II, King, 129
Civil Code, 146
Civil War, 29
Cleveland, Grover, 8
Clearing house, work of, 24
Code Napoleon, 146
Collection, attorneys, 126
  good policy for, 120
  letters, 115
  of checks, 133
  organizations for, 126
  unsafe schemes, 134
Commerce, Department of, credit information department, 187
Cooperation, 88
  effect on frauds, 159
  importance of, vii, 10

Correspondence, collection (*see* separate item)
  credit, 112-119
  negatives not effective, 116
  proper reaction to, 113
  relation to management, 112
  three fundamentals of, 116
  ways of arousing interest, 115
Credit, abuses, 40
  as a medium of exchange, 15
  bank, 28
  basis of, 18, 71
  "charging" goods, 29
  chemistry of, 21
  clearance facilities, 24
  commercial, 29
  competition, 9
  crimes against, 157-166
  debtor's obligation, 41
  defined, 17
  department (*see* Credit department)
  early methods, 87
  economics, 70
  extrinsic hazards, 53
  flexibility, 24
  foreign, 187 *et seq.*
  growth during and after World War, 12
  hazards guarded against, 50 *et seq.*
  historic background, 1 *et seq.*
  individual, 34
  inflation, 42
  information, 87
  intrinsic hazards, 50
  investment, 27
  minting in relation to, 26
  non-commercial uses, 39
  not capital, 39
  open book account, 29
  private, 27
  public, 27
  relation to industrial expansion, 11
  relation to sales, 49
  types, 26 *et seq.*
  use in speculation, 75
  uses of, 36
  waste, 177
Credit department, equipment, 45
  location, 45
Credit department—*(continued)*
  personnel, 45
  research and creative work, 46
  responsibilities, 43
  status of the letter, 112
  threefold task, 50
Credit management (*see* Credit managers)
Credit managers, conventions, 9
  "credit sense," 63-69
  good judgment needed, 23
  need for comprehensive information, 46
  new conception of task, 63
  qualities needed, 56-62, 189
  tools of, 78-111
Creditor, attitude toward credit crimes, 166
  attitude toward survey, 183
  position regarding failures, 144
Credit Protection Department, 165
  investigation by, 160 *et seq.*
Currency, credit is present, 70

Debtor, cooperation of, 183
  responsibility for failure, 140
Delaware, 132
Depreciation, 78, 80
  tests for measuring, 81
Discount, for cash, 31
District of Columbia, 132, 133
Domestic trade, 37
Donovan, William J., probe into bankruptcy administration, 155
Dun, R. G. & Co., 98

England, bankruptcy law, 146, 156
Experience, interchange of credit, 87-97
  methods of interchange, 90
  (*see also* Information)
Exports, record years, 10, 12

Failures, business, 7
  causes and prevention, 138-145
  credit, 139
  creditor's fault, 144
  debtor's faults, 140
  prevention of, 144
Federal Reserve System, evolution of, 72

Federal Reserve System—*(cont'd)*
  first great test, 75
  inauguration, 12
  privileges to banks, 29
  reserves in member banks, 38
  task in 1929, 75
Foreign trade, 6
  growth, 37
  post-war, 186
Forms, information, 91-95
France, bankruptcy law, 146
Frauds, assumed name, 162
  by mail, 159
  organized prosecution, 159
  punishable, 158
  statute of, 129
  typical cases, 161
  unpunishable, 157
Friendly liquidation, 167-176
  conditions of, 169
  development, 169
  economies of, 174
  origin of cases, 174

Gold, base of credit, 71
  base uncomfortably small, 7
  exports, 8
  imports, 72
  Standard Act, 10

Hamilton, Alexander, financial genius, 3
Hawaii, 133
Hoover, Herbert, work on foreign trade, 187

Imports, gold, 72
  in 1900, 10
Industrial Revolution, 2
Industry, situation in 1890, 8
  situation in 1901, 10
Inflation, cause of panics, 73
  dangers of credit, 42, 73
Information, attorney's opinion of doubtful value, 109
  from salesmen, 107
  on foreign buyers, 187
  supplied by bank, 108
  various sources, 105-111
  (*see also* Experience)
Installment selling, 40
Insurance, casualty, 100
International Chamber of Commerce, 188
Invention, 6

Klein, Dr. Julius, work on foreign trade, 187

Law, bankruptcy (*see* Bankruptcy law)
  business (*see* Business law)
  credit transactions protected, 11
Legislation, on bankruptcy, 147
Letters (*see* Correspondence)
Liquidation, 167-176
  extra-judicial, 168
  friendly (*see* separate item)
  judicial, 167
Loans, bank, 42
  public, 39
Los Angeles Wholesalers Board of Trade, 175
Losses, fire and water, 102

Mails, used to defraud, 159, 161
Manual of Commercial Laws, 137
Maryland, 132
Mercantile agency, antecedents valuable, 101
  development of service, 98
  information furnished, 99
  interpreting reports, 104
  reference book, 103
  reports, 98-104
  value of reports, 103
Merchants, earliest known, 1
Money, gold and silver (*see* separate items)
  present circulation, 23
  specie, 5
Morris, Robert, 3
Mortgages, chattel, 134

National Association of Credit Men, 89, 91, 127, 137, 156, 159, 169, 178, 188
  formation, 9
National Bank Act, limitation, 12
New York County Lawyers Association, 155

Panics, 1873, 4
  1884, 7
  1893, 8
  1907, 11
Pennsylvania, 132
Personal interview, 105
Philadelphia, centennial celebration, 5
Philippine Islands, 133
Production, mass, viii
  power, 2
Profits, 80
  tests for measuring, 81
Promissory notes and drafts, 32
Prosecutions, organized movement, 159

Railroads, building, 4
Ratios, velocity liquidation, 81
Receiver, 151
Referee, 151
Rhode Island, 132

Sales, and cancellations, 130
  conditional, 134
Securities, market flooded by, 75
Service, business, 177-185
  cases of, 184
  individual action, 180
  organized action, 181
  prevention, 178
  remedial work, 179
  saving credit waste, 177
  wide field for, 178
Silver, 7
  Coinage Act of 1878, 6
  theory affected credit, 10
Speculation, credit used for, 41
  post-war orgy, 74
Statements, false financial, 85
  financial, 78
  operating, 78
  property questionnaire, 85
  uses of, 80
Stock market, 7
  brokers' demands for credit, 76
  episode in 1929, 75

Trade, development, 2
  early forms, 2, 36
  groups, 96
  opinions valuable, 100
Trade acceptances, 33
Trading, barter, 14
  early "money," 14
  fundamentals, 14, 18
Trustee, 151

United States, bankruptcy in the, 147
  credit in colonial, 2 *et seq.*

"What Price Bankruptcy: a Plea for Friendly Adjustment," Billig, 176
Willing, Thomas, 4
World War, 72
  effects on credit, 12, 186

Date Due

Feb 5'42
AUG - 9 REC'D
MAR 18
N. Far
staff
NOV 29 1974
JAN 24 1958
NOV 18 1974 RET'D
MAR 16
FEB 21 1977
7 Jan 54 C 206
FEB 24 1977 RET'D
AUG 13
FEB 7 1966
FEB 4 REC'D

UNIVERSITY OF B.C. LIBRARY
3 9424 01381 9492

CALL NO. HF5566. T 7
AUTHOR Tregoe, J. H.
TITLE Credit and its management.
Library of The University of British Columbia